交通銀行 BANK OF COMMUNICATIONS BBM

MACRO OUTLOOK

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Macro Outlook

- Incoming data from developed economies points to a resilient activity and to a tight labor market that's beginning to show some signs of better balance between supply and demand. Inflation remains somewhat persistent, although the core CPI in the US fell more decisively in June. Altogether this should require a longer period of tight monetary policy and reinforces the possibility of a gradual slowdown consistent with a 'soft-landing' scenario. Accordingly, the FOMC raised the Fed funds rate by 25bps to the range of 5.25-5.50%. The market's expecting this to be the last hike of the cycle, despite the fact that the latest set of FOMC projections pointed to the possibility of one additional hike this year.

- As for China, recent data confirmed that economic activity continues its recovery path, showing challenges in property-related sectors, but strength in others. The GDP grew 5.5% in the first half of this year with some slowdown in Q2 but above the 5% annual target so far. In response to the slowing momentum, the July Politburo meeting set a more supportive pro-growth tone for H2 that reinforces the necessity for stronger counter-cyclical macro policies in order to help boost consumers and companies confidence, as well as stabilize housing demand.

- In Brazil, economic activity has gradually slowed down, given tight credit conditions and high household debt. However, the resilience of the labor market, greater government cash transfers and falling inflation have brought relief to activity in the short term. We maintain our GDP growth forecast of 0.3% QoQ in Q2 and 2.0% in the year;

- Regarding the monetary policy, the Brazilian Central Bank decided to cut Selic rates by 50 bps in its August meeting, reaching 13.25% per year. While the beginning of the easing cycle was largely expected, the magnitude of the cut was uncertain. 4 members voted for a 25bps cut, while 5 members voted for a 50bps cut. The BCB projections indicate that rates reaching 12% by 2023 and 9.25% by 2024 would bring inflation to 4,9% in 2023, 3,4% in 2024 and 3% in 2025. The easing cycle still requires "serenity" and "moderation", and the committee foresees other cuts of the same magnitude (50 bps) in the following meetings if the economic scenario turns out as expected. The decision and communication came in line with our expectations, so we maintain the scenario of a terminal interest rate of 11.75% by the end of 2023 and 9% in 2024;

- In the inflation scenario, our projection for 2023 stands at 4.8%. After the IPCA preview for July, we revised downwards the projections for services, industrial goods, and food, which were offset by an increase in regulated prices, resulting in a better overall composition. For 2024, we maintain our projection at 3.6%;

- The consolidated public sector recorded a primary deficit of BRL 48.9 billion in June, with the central government registering a deficit of BRL 46.5 billion, subnational governments a deficit of BRL 0.9 billion and state-owned companies reaching negative result of BRL 1.5 billion. This is the first deficit after 19 months of surplus. The Gross General Government Debt remained unchanged at 73.6% in June. The positive contribution from 'Interest Settlement' (0.6 pp. of GDP) was offset by net issuance (-0.1 pp.), exchange rate appreciation (-0.2 pp.) and nominal GDP growth (-0.3 pp.).

China: GDP 2023 Q2

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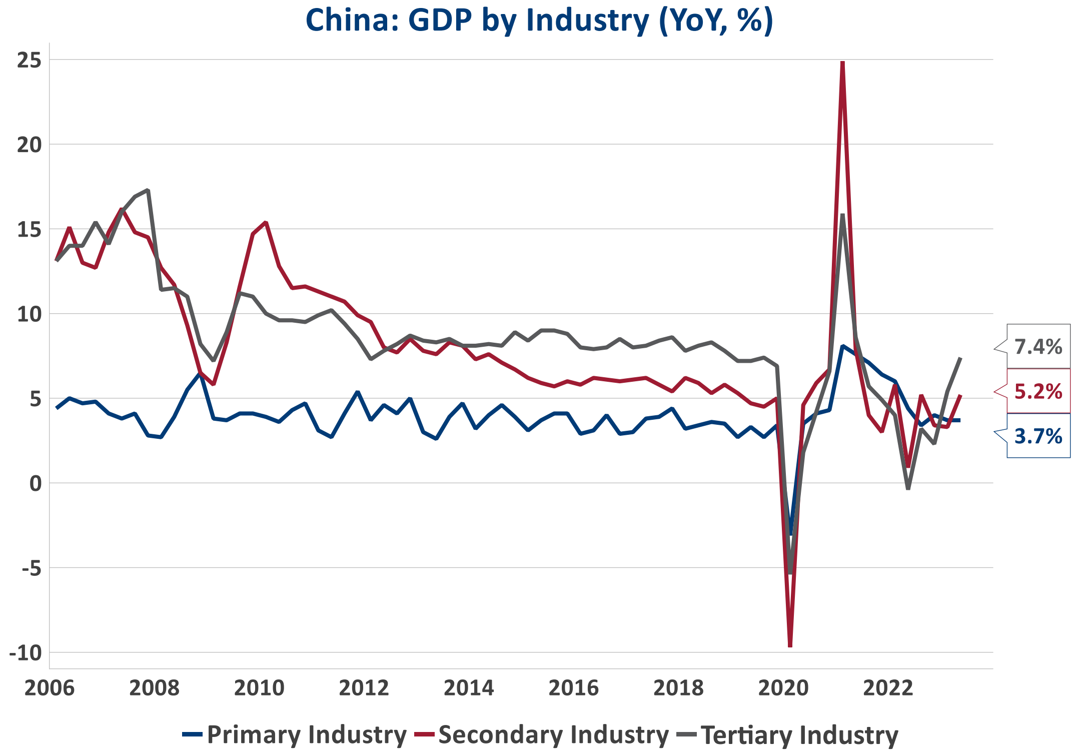
- China's 2023 Q2 real GDP accelerated from 4.5% to **6.3%** YoY on a low base from last year's Shanghai lockdown, although missing market expectations of 7.1% YoY growth:
  - On a QoQ SA basis, the NBS reported a better-than-expected slowdown to a pace of **0.8%** QoQ (exp. 0.5%) from 2.2% in Q1;
  - Sectorial data pointed to a faster growth in tertiary (7.4% YoY) and secondary sectors (5.2% YoY), while primary sector grew more modestly;

- On the upside, China's GDP grew 5.5% YTD YoY in H1 this year, above the central government target of 5% YoY;
- Nonetheless, the sequential slowdown prompted a more **supportive pro-growth tone**, reinforced in July's Politburo meeting with easing measures that might help boost confidence, consumption and stabilize the property sector.

Source: BOCOM BBM, Macrobond, NBS

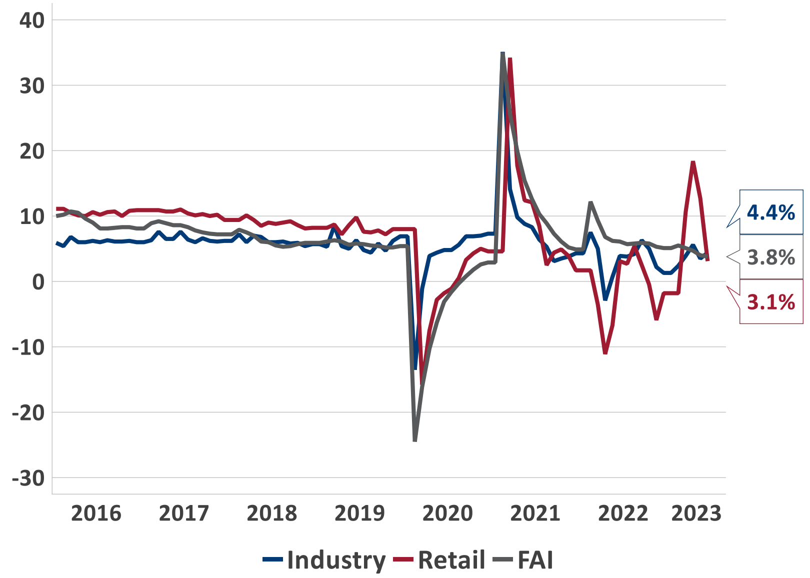


Source: BOCOM BBM, Macrobond, NBS

China: Activity

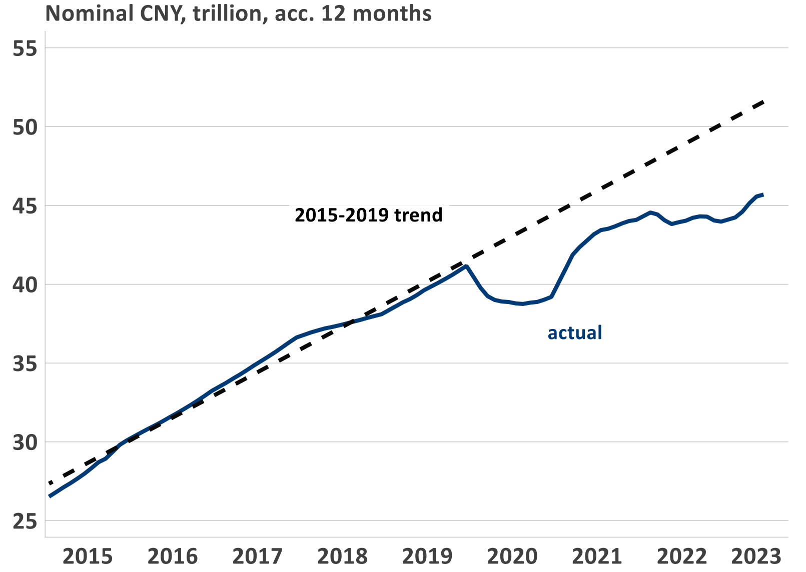
- June economic activity either matched or were above expectations on YoY terms, and had mixed results on a sequential basis:
- **Industrial production increased** from 3.5% to **4.4%** YoY (exp 2.7%), driven by growth in manufacturing (4.8% vs. 4.1% in May) and a rebound in mining (1.5% vs. -1.2% YoY in May) – on a sequential basis, the industrial value-added rose 0.68% MoM (vs. 0.63% in May);
- **Retail sales decreased** from 12.7% to **3.1%** YoY (exp 3.2%) mainly due to a high base last year: highlights were slower growth in Covid-sensitive sectors (e.g. restaurants), and a slowdown in auto sales suggesting initial strength of pent-up demand after reopening may be fading;
- **FAI declined** from 4.0% to **3.8% YTD YoY** (exp. 3.5%) mainly due to stronger infrastructure and manufacturing investment growth on the back of more policy support, but offset by a decrease of -7.9% YTD YoY in real estate investment;
- The **national and 31-city unemployment rates remained stable at 5.2%** and **5.5%**, respectively, however the unemployment among young people (age 16-24) rose further to 21.3% (from 20.8%), reflecting the consequences of college expansion and labor supply & demand mismatch.

China: Activity (YoY, %)



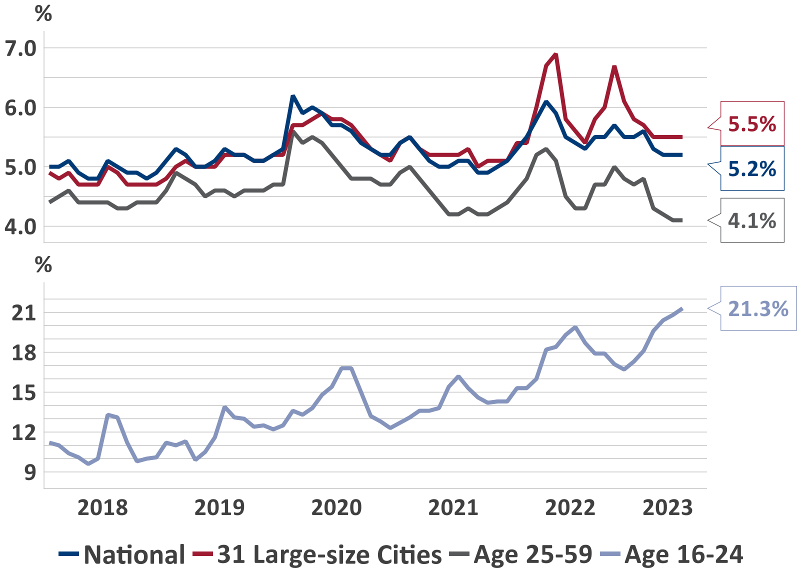
Source: BOCOM BBM, Macrobond, NBS

China: Retail Sales



Source: BOCOM BBM, Macrobond, NBS

China: Unemployment Rate in Urban Areas



Source: BOCOM BBM, Macrobond, NBS

China: Economic Scenario

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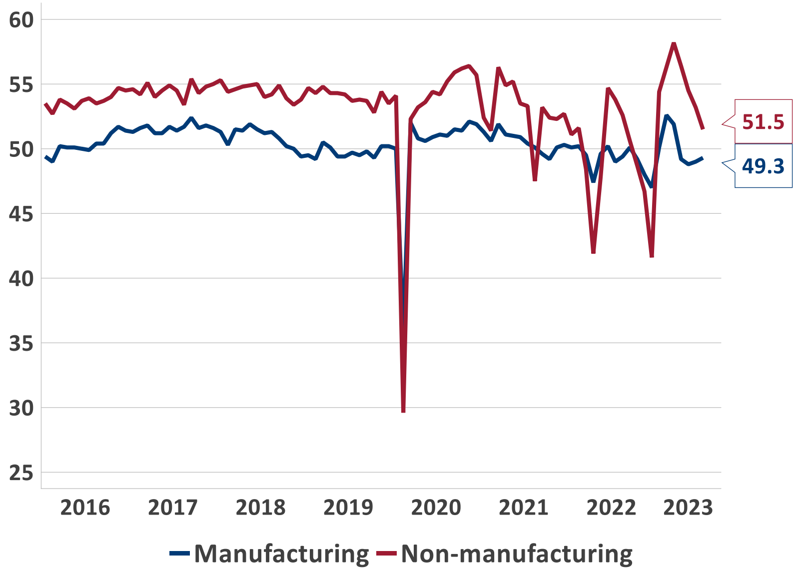
- In July, China's **PMI** still shows a divergence in recovery between the manufacturing and non-manufacturing sectors, although the gap's narrowing as the latter's losing strength;
  - The NBS manufacturing PMI rose from 49.0 to **49.3** (exp. 48.9) due to sluggish external demand and insufficient pickup in domestic demand;
  - The non-manufacturing sector continued expansionary but in the softest pace since January, moving from 53.2 to **51.5**;

- **Exports** fell more than expected, from -7.5% to **-12.4% YoY** (exp. -10%), representing a broad slowdown in multiple products and destinations due to weaker external demand;
- **Imports** remained negative, falling from -4.5% to **-6.8% YoY**, mostly due to falling commodity prices;

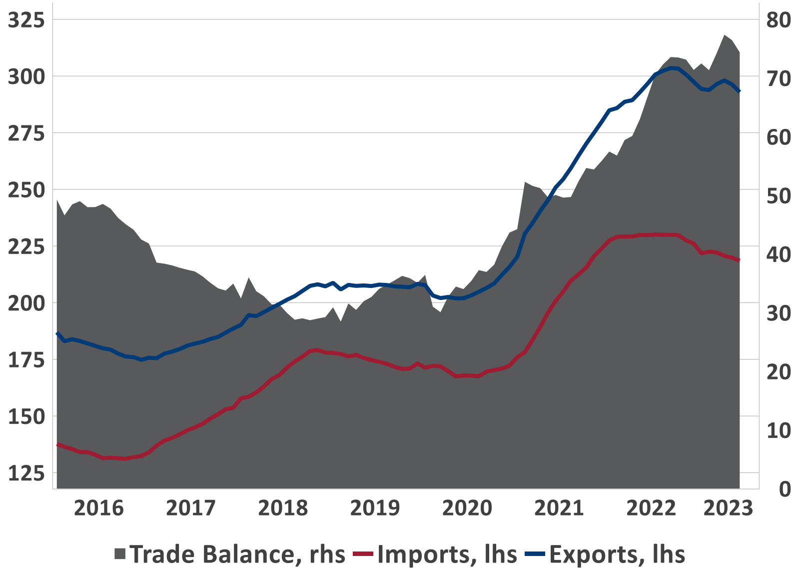
- **CPI** inflation fell **-0.2%** MoM (exp. 0%) moving from 0.2% to **0%** YoY (exp. 0.2%), primarily on a high base from post-lockdown demand strengthening last June;
  - Goods deflation persisted, driven by falling fuel costs, and services inflation remained soft, reflecting underwhelming demand;

China: PMI



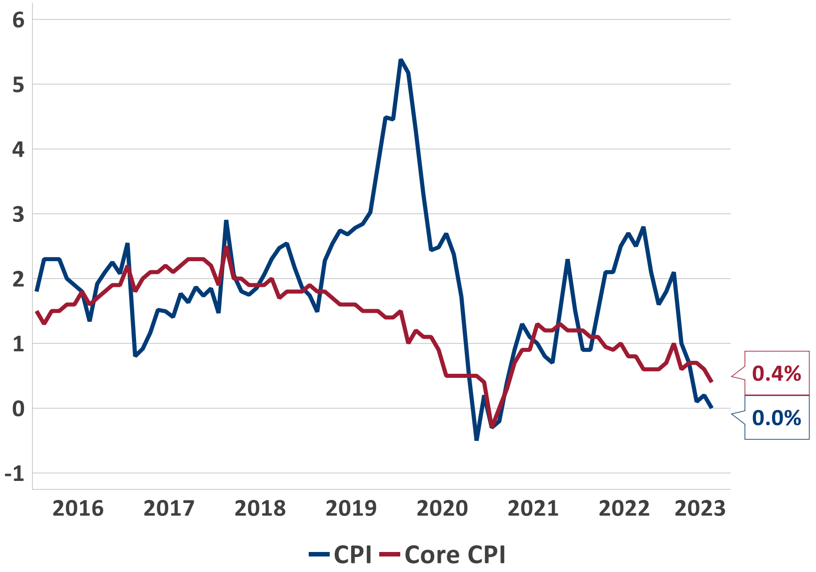
Source: BOCOM BBM, Macrobond, CFLP

China: Trade Balance (USD billion, 12MMA)



Source: BOCOM BBM, Macrobond, CCS

China: CPI (YoY, %)



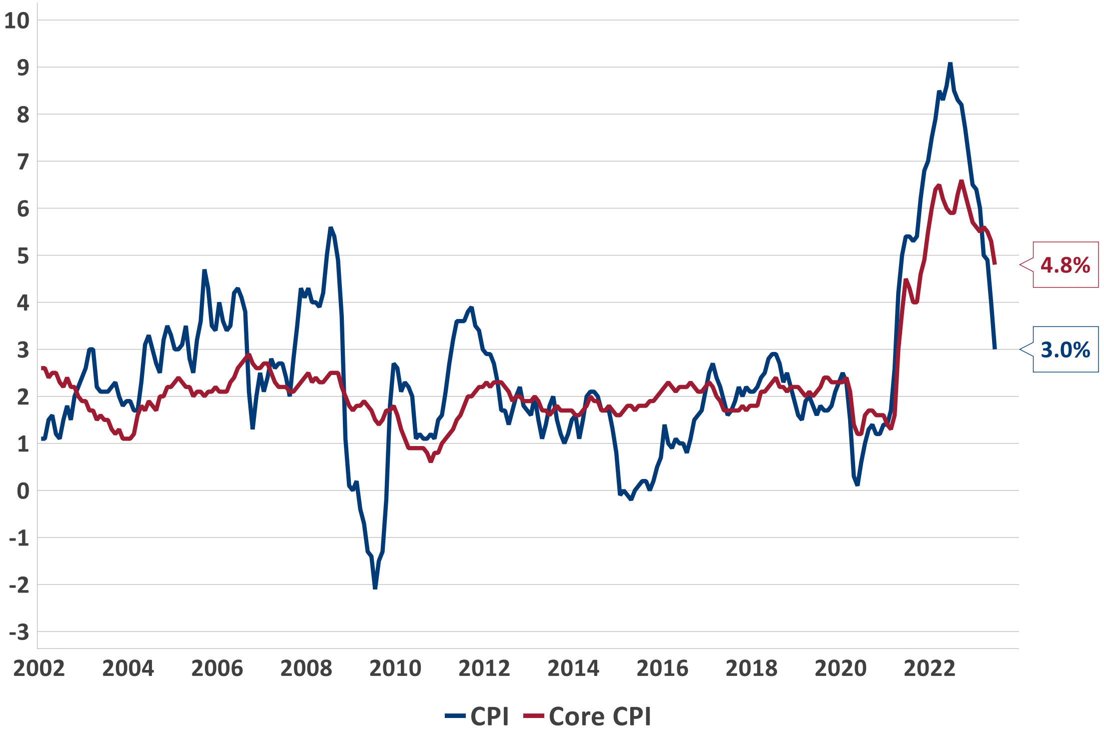
Source: BOCOM BBM, Macrobond, NBS

USA: Inflation

- June **headline CPI** arrived slightly below expectations, moving from 4.0% to **3.0%** YoY and increasing by **0.2%** MoM (exp. 0.3%)
  - Energy prices increased (0.6% MoM) backed by higher gasoline and electricity prices, but remain the primary source of annual disinflation;
  - Food prices continues to moderate with a slower pace when compared to early 2023 or previous year inflation;

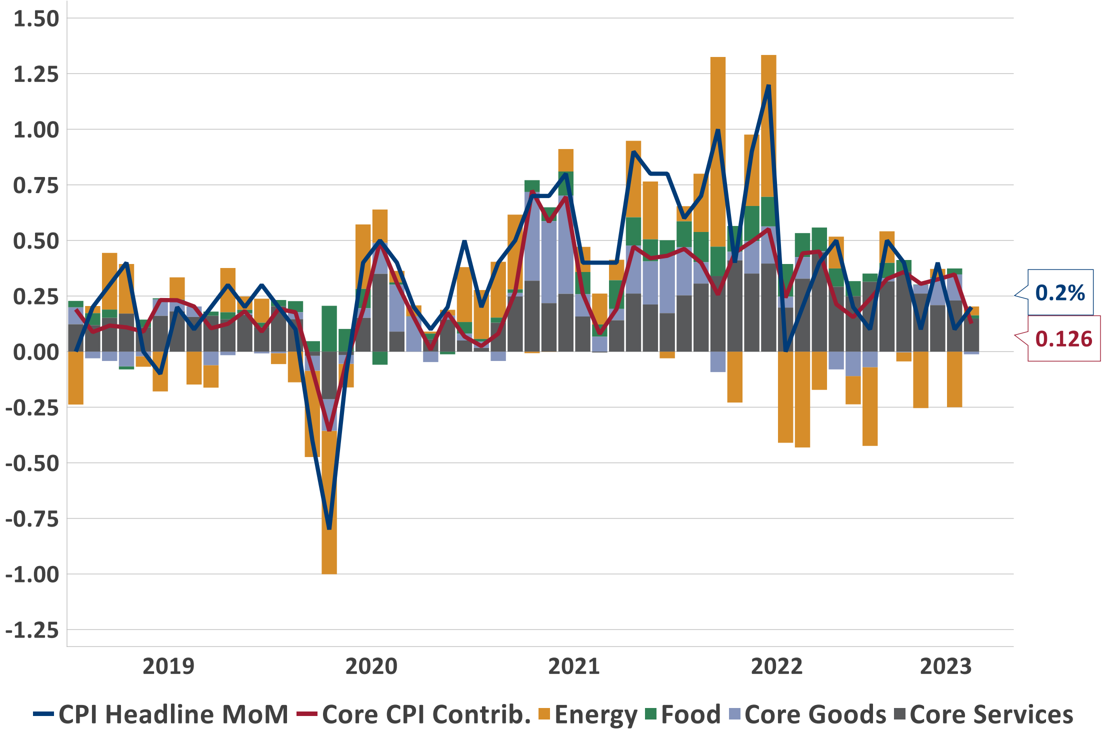
- **Core CPI** increased **0.2%** MoM, reaching **4.8%** YoY (from 5.3%), finally showing some clearer sign of desinflation:
  - We're still seeing pressure coming from **core services** (0.14% MoM), although with lesser strength due to OER and rent of primary residence continuing to slowdown, and other ex-housing services also decelerating (0% MoM);
  - **Core goods** fell back into monthly deflation (-0.1% MoM) mainly due to relief in used cars & trucks, adding into the other well-behaved components;

US: CPI (YoY, %)



Source: BOCOM BBM, Macrobond, BLS

US: CPI MoM Contributions



Source: BOCOM BBM, Macrobond, BLS

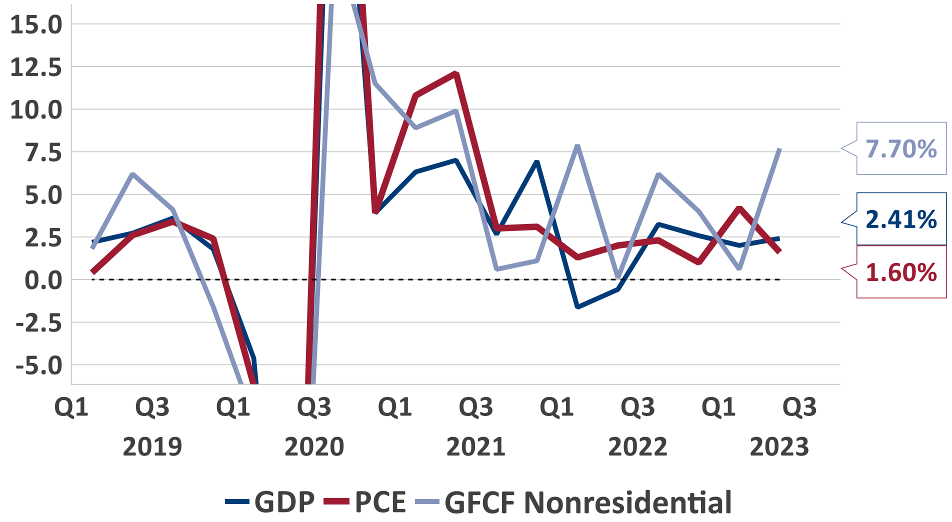
US: 2Q 2023 GDP

- Q2 GDP printed a **2.4%** QoQ SAAR growth, above Q1 pace of 2.0% and consensus expectations of 1.8% QoQ SAAR;

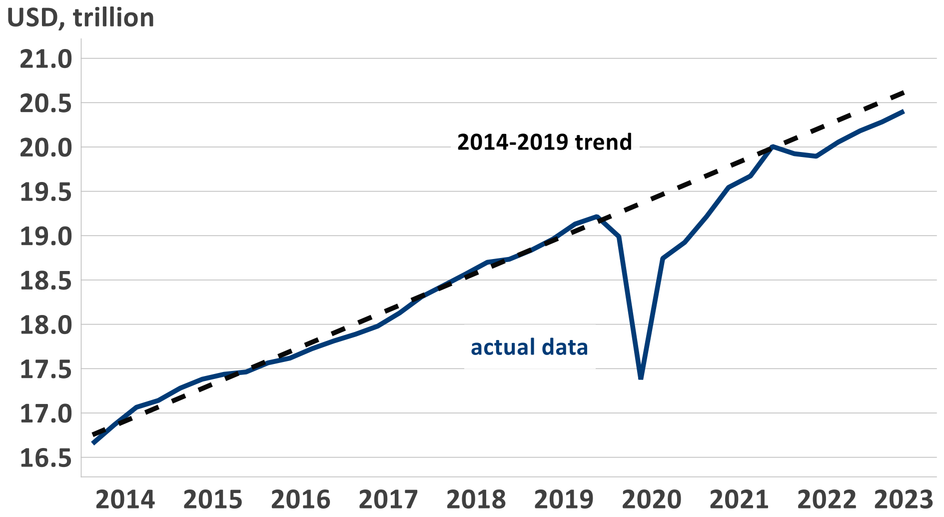
- Main takeaway relative to 23Q1:
  - **Household spending slowing down by less than expected;**
  - Stronger than expected growth in **GFCF non-residential**, mainly on structures and equipment;
  - Smaller than expected contribution from inventories suggesting potentially less drag from destocking over the coming quarters.

- All in all, this reading underpins the surprising resiliency of the US economy and corroborates with the 'soft-landing' narrative.

US: Real GDP (QoQ SAAR, %)

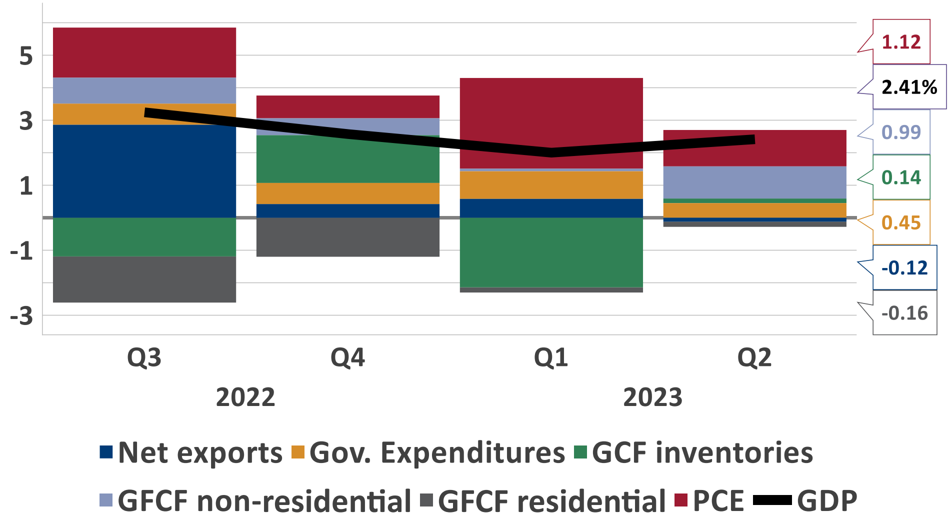


US: Real GDP vs Pre-pandemic



Source: BOCOM BBM, Macrobond, BEA

US: Contribution to GDP-growth (QoQ SAAR, %)

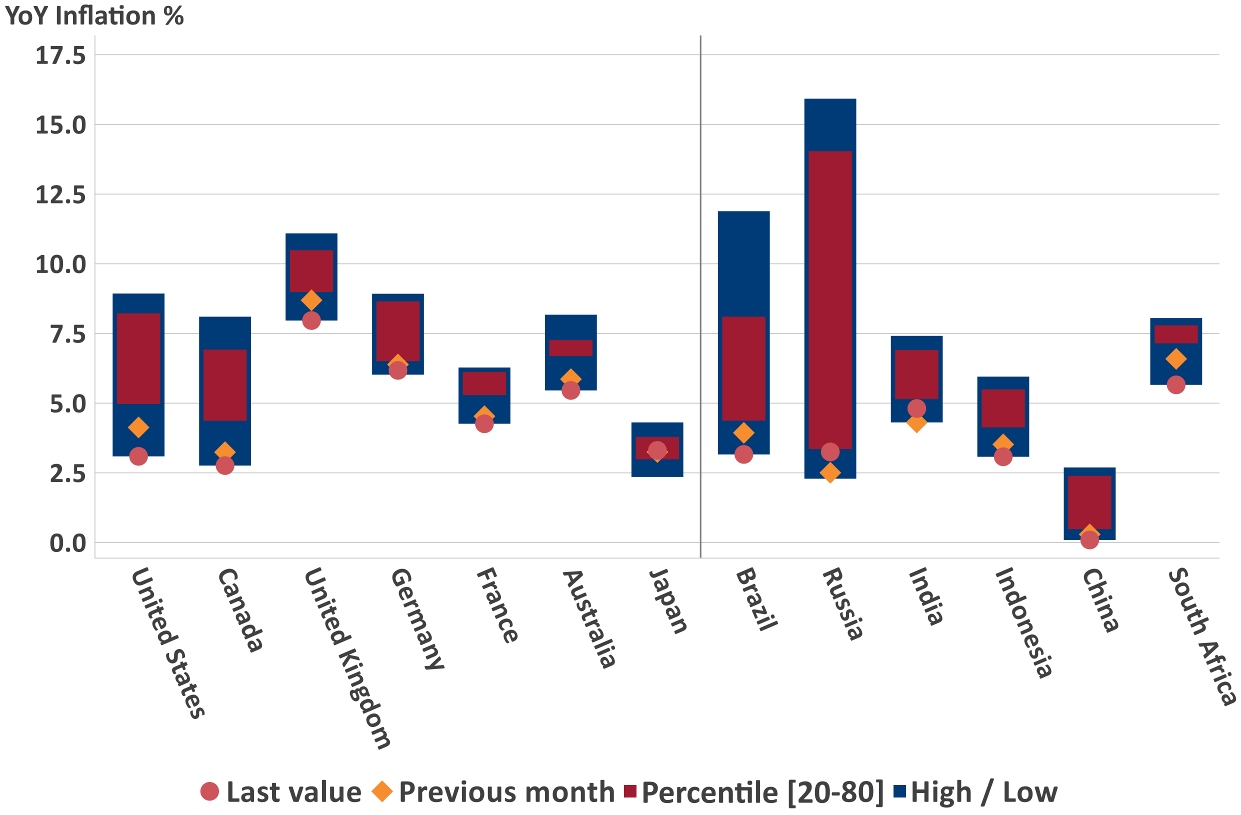


Source: BOCOM BBM, Macrobond, BEA

Global: Inflation & Activity

- For the first time in decades, inflation across emerging markets is not significantly higher than it is in developed markets;
- In order to bring inflation convergence back to their respective targets, many central banks tightened sharply their monetary policy over the past year resulting in a slowdown to economic activity across several countries, although some showed remarkable resiliency;
  - 3 OECD nations are showing a technical recession in 2023 (2 quarters of negative growth): Germany, Ireland & New Zealand.

Inflation range during the past 12 months



Source: BOCOM BBM, Macrobond

Recession Tracker

Number of countries in recession per year
Sample universe across 35 OECD nations

	Share (%)	#
2023	8.6	3
2022	20.0	7
2021	5.7	2
2020	85.7	30
2019	8.6	3
2018	5.7	2
2017	2.9	1
2016	2.9	1
2015	11.4	4
2014	11.4	4
2013	8.6	3
2012	28.6	10
2011	14.3	5
2010	14.3	5
2009	31.4	11
2008	65.7	23
2007	8.6	3
2006	2.9	1
2005	8.6	3
2004	5.7	2
2003	14.3	5
2002	17.1	6
2001	25.7	9
2000	5.7	2

Source: BOCOM BBM, Macrobond, National Sources

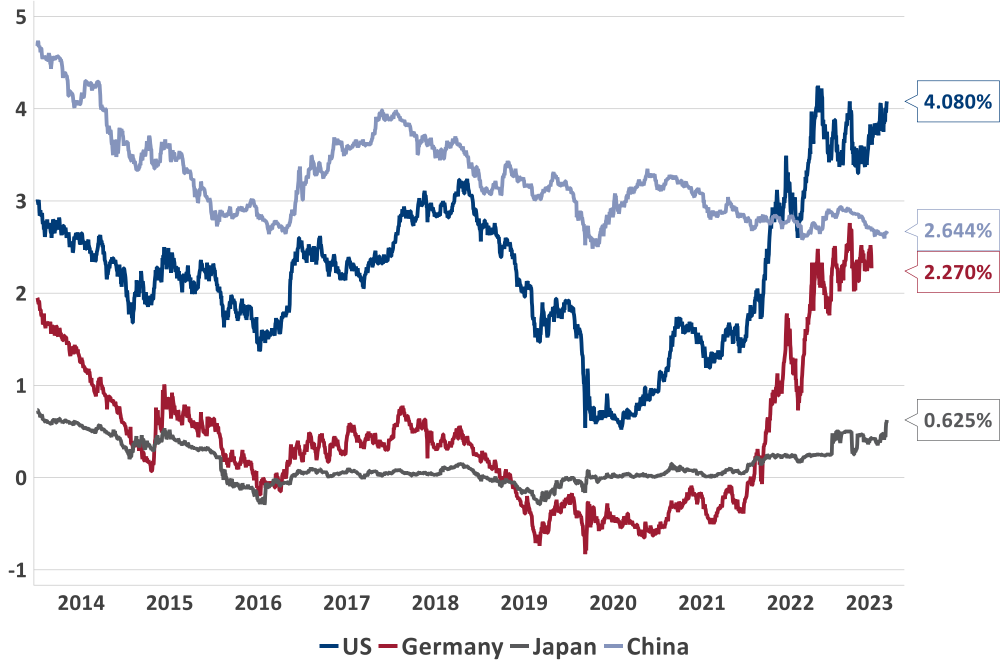
Global: Interest Rates

- Monetary policy tightening cycle seems to be approaching the peak in several countries, and some have already started easing such as Chile and Brazil;

- The FOMC raised the Fed funds rate by 25bps in its July meeting, which the market expects to be the last hike of the cycle, even though the latest FOMC projections released in June hinted one additional hike could happen;

- Moreover, the FOMC staff is no longer forecasting a recession as their baseline scenario, which also reinforces the narrative of a 'soft-landing'.

10 Year Interest Rates (%)



Source: BOCOM BBM, Macrobond, BUBA, JBT, CCDC

Central bank tracker: G20 & OECD Countries

	Key rate	Last decision		Last Move	Months since last hike	Months since last cut
Argentina	97.00	6.00	Hike	5/2023	3	33
Australia	4.10	0.25	Hike	6/2023	2	33
Brazil	13.25	-0.50	Cut	8/2023	12	0
Canada	5.00	0.25	Hike	7/2023	1	40
Chile	10.25	-1.00	Cut	7/2023	10	0
China	3.55	-0.10	Cut	6/2023	114	2
Colombia	13.25	0.25	Hike	5/2023	3	34
Costa Rica	6.50	-0.50	Cut	7/2023	9	0
Czech Republic	7.00	1.25	Hike	6/2022	13	39
Denmark	3.50	0.25	Hike	7/2023	0	22
Euro Area	4.25	0.25	Hike	8/2023	0	89
Hungary	13.00	1.25	Hike	9/2022	10	36
Iceland	8.75	1.25	Hike	5/2023	2	33
India	6.50	0.25	Hike	2/2023	6	38
Indonesia	5.75	0.25	Hike	1/2023	7	30
Israel	4.75	0.25	Hike	5/2023	2	40
Japan	-0.10	-0.20	Cut	1/2016	197	90
Mexico	11.25	0.25	Hike	3/2023	4	30
New Zealand	5.50	0.25	Hike	5/2023	2	41
Norway	3.75	0.50	Hike	6/2023	1	39
Poland	6.75	0.25	Hike	9/2022	11	38
Russia	8.50	1.00	Hike	7/2023	0	11
Saudi Arabia	6.00	0.25	Hike	7/2023	0	41
South Africa	8.25	0.50	Hike	5/2023	2	36
South Korea	3.50	0.25	Hike	1/2023	7	38
Sweden	3.75	0.25	Hike	7/2023	1	90
Switzerland	1.75	0.25	Hike	6/2023	1	103
Turkey	17.50	2.50	Hike	7/2023	0	5
United Kingdom	5.25	0.25	Hike	8/2023	0	41
United States	5.50	0.25	Hike	7/2023	0	41

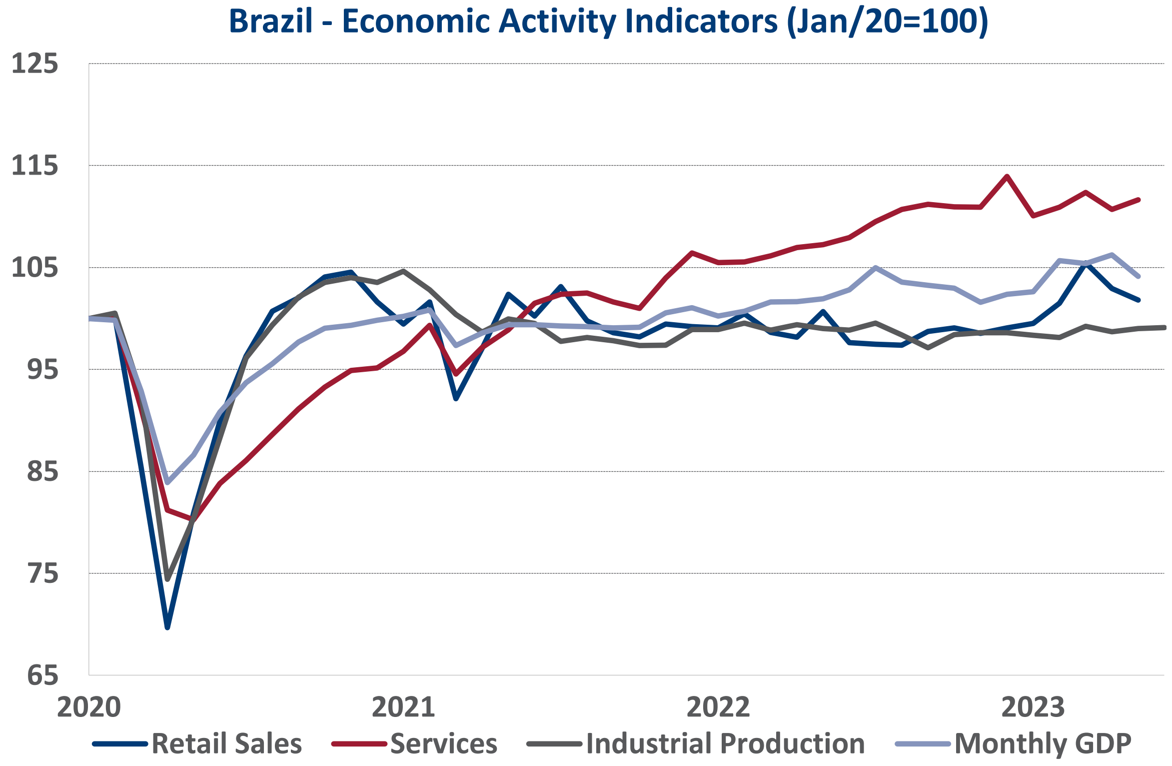
Brazil: Forecasts

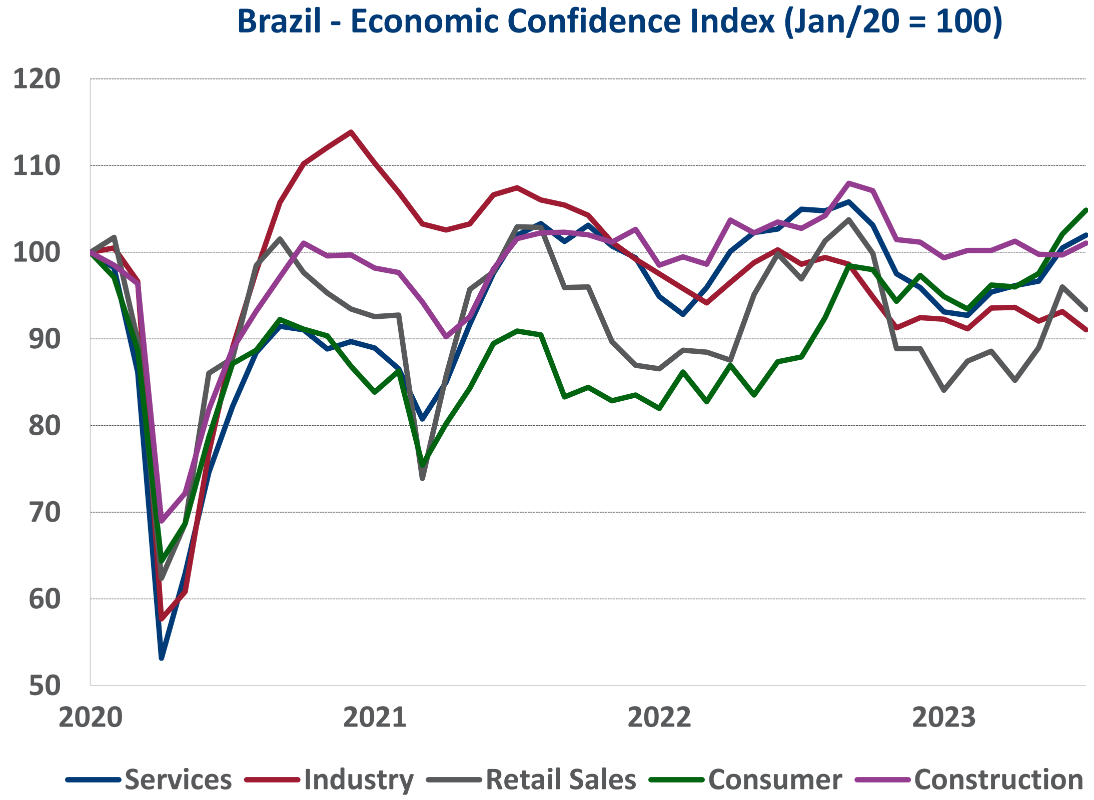
ECONOMIC FORECASTS	2019	2020	2021	2022F	2023F	2024F
GDP Growth (%)	1.2%	-3.3%	5.0%	2.9%	2.0%	1.0%
Inflation (%)	4.3%	4.5%	10.1%	5.8%	4.8%	3.6%
Unemployment Rate (eoy ,%)	11.1%	14.2%	11.1%	7.9%	8.8%	9.3%
Policy Rate (eoy, %)	4.5%	2.0%	9.3%	13.75%	11.75%	9.0%
External Accounts						
Trade Balance (US$ bn)	27	32	36	44	60	42
Current Account Balance (US$ bn)	-68	-28	-46	-56	-39	-50
Current Account Balance (% of GDP)	-3.6%	-1.9%	-2.8%	-2.9%	-1.8%	-2.3%
Fiscal Policy						
Central Government Primary Balance (% of GDP)	-1.3%	-9.8%	-0.4%	0.6%	-1.1%	-1.2%
Government Gross Debt (% of GDP)	74.3%	86.9%	78.8%	72.9%	76.6%	81.4%

Source: BOCOM BBM

Brazil: Activity

- The main monthly indicators of economic activity showed mixed signs in May. Retail sales fell by 1.1% MoM, while the services sector increased by 0.9% MoM and industrial production advanced 0.3% MoM. In June, industrial production registered another rise at the margin (0.1% MoM);
- Confidence indicators, in turn, showed divergent directions for July, since there was an increase in consumer confidence, services and construction, while the industry and retail sales confidence dropped.

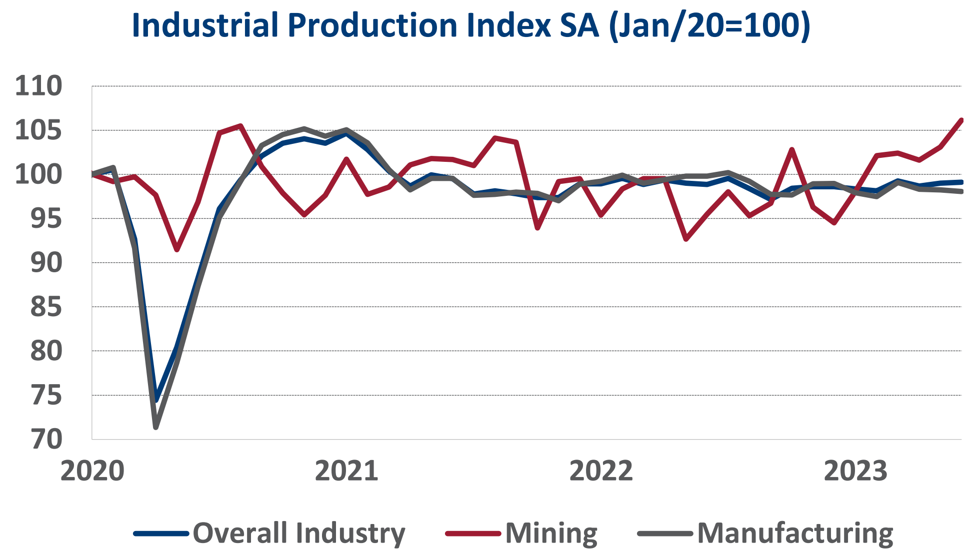


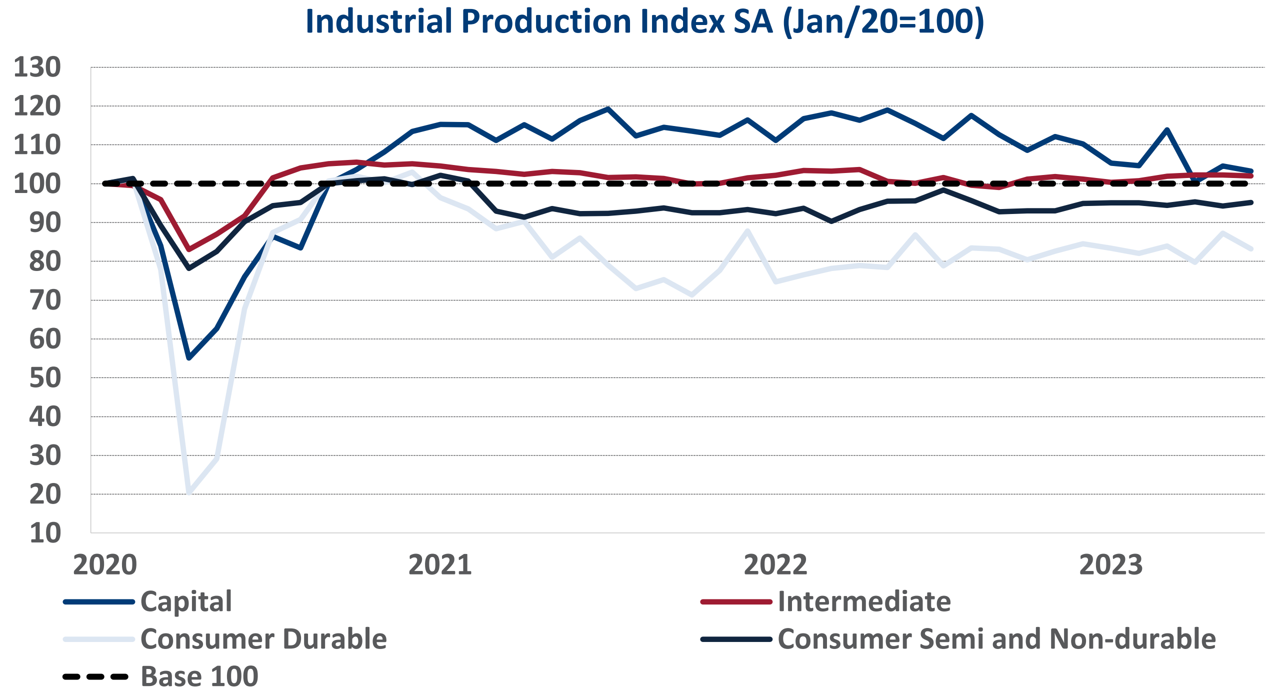


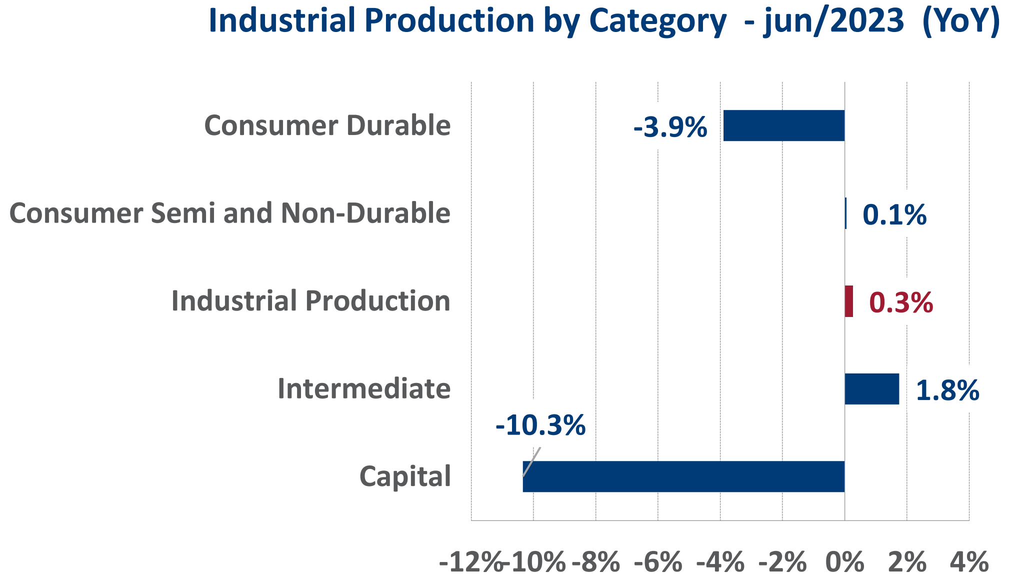
Source: BOCOM BBM, FGV

Brazil: Industrial Production

- Industrial production grew 0.3% in May and 0.1% MoM in June, above market expectations (0.0% and -0.1% MoM, respectively), ending the quarter with a 0.4% QoQ growth;
- In the categories, 'Mining industry' grew 2.7% QoQ and 12.3% from Dec-Jun 2023. Other positive highlights in the recent period are 'Oil Derivatives and Biofuels' (9.0% QoQ and 8.9% in the first half of 2023) and 'Textile Products' which rose for the fifth time in the last six readings (1.2% MoM; 4.9% QoQ);
- On the other hand, the production of capital goods has dropped significantly, as a result of high interest rates and elevated corporate indebtedness.



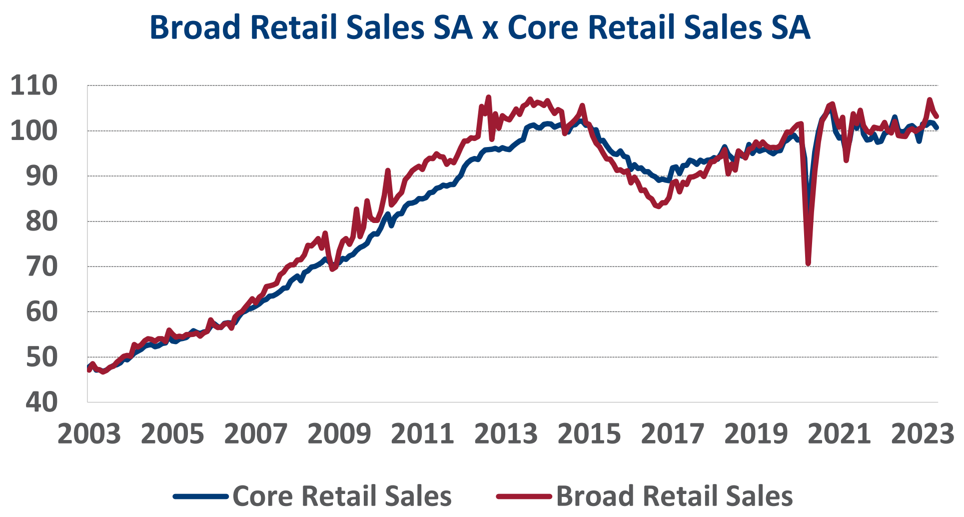


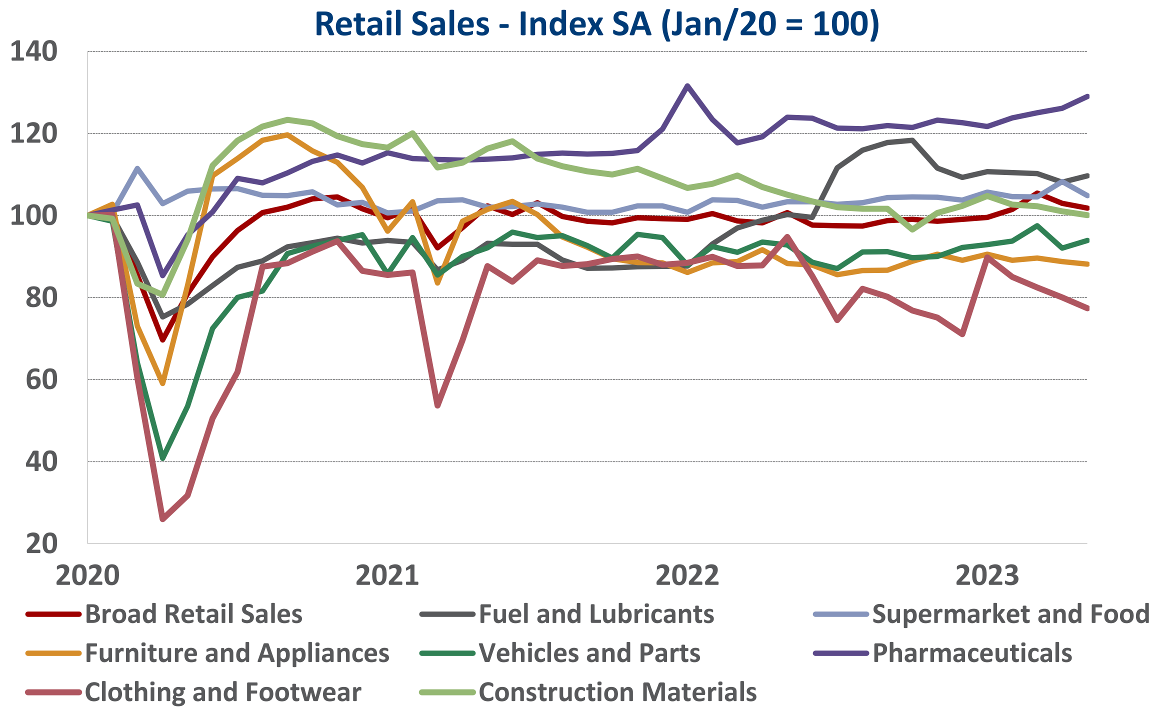


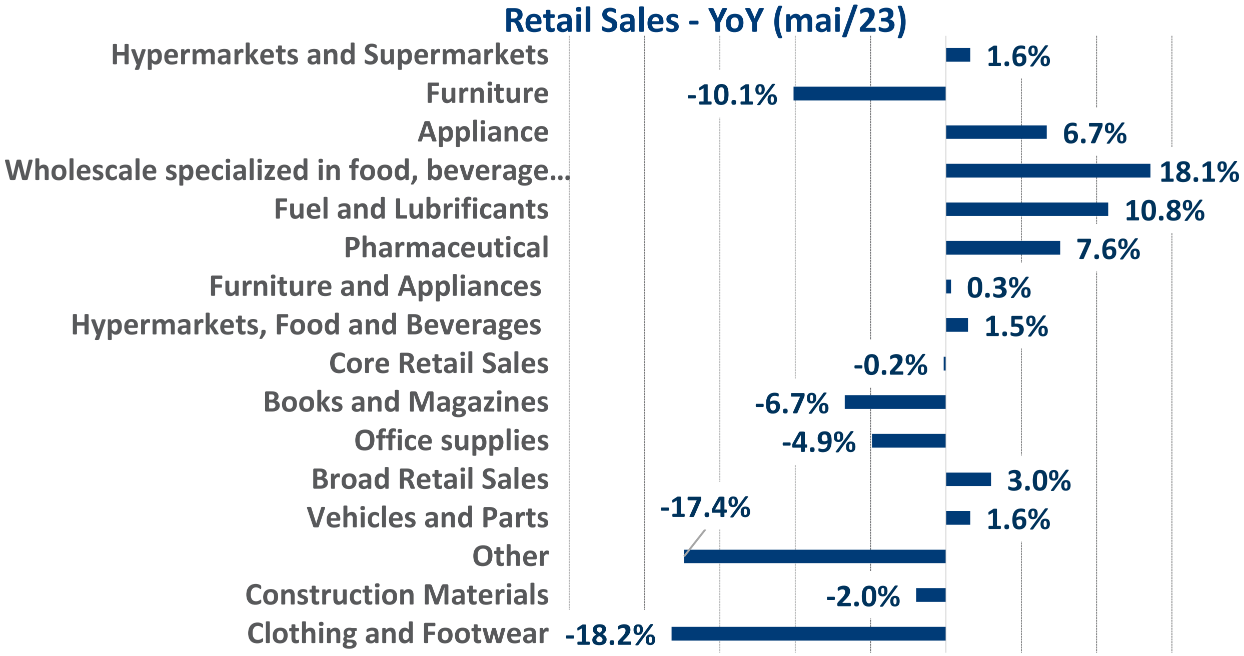
Source: IBGE, BOCOM BBM

Brazil: Retail Sales

- Broad retail sales dropped 1.1% MoM (3.0% YoY) in May, the second consecutive fall. The core retail sales, in turn, fell 1.0% MoM (-1.0% YoY), worse than market expectations (-0.3% MoM);
- Five out of ten sectors fell on the margin. Among the negative contributions are Hypermarkets, food and beverages, which fell -3.2% MoM and the sales of Construction Materials, which recorded the fourth consecutive monthly drop (-0.9% MoM). On the other hand, the Pharmaceuticals sector (+2.3% MoM) and Vehicles (+2.1% MoM) were positive highlights;
- The downturn in retail sales is a consequence of the scenario of credit retraction amid a contractionary monetary policy.



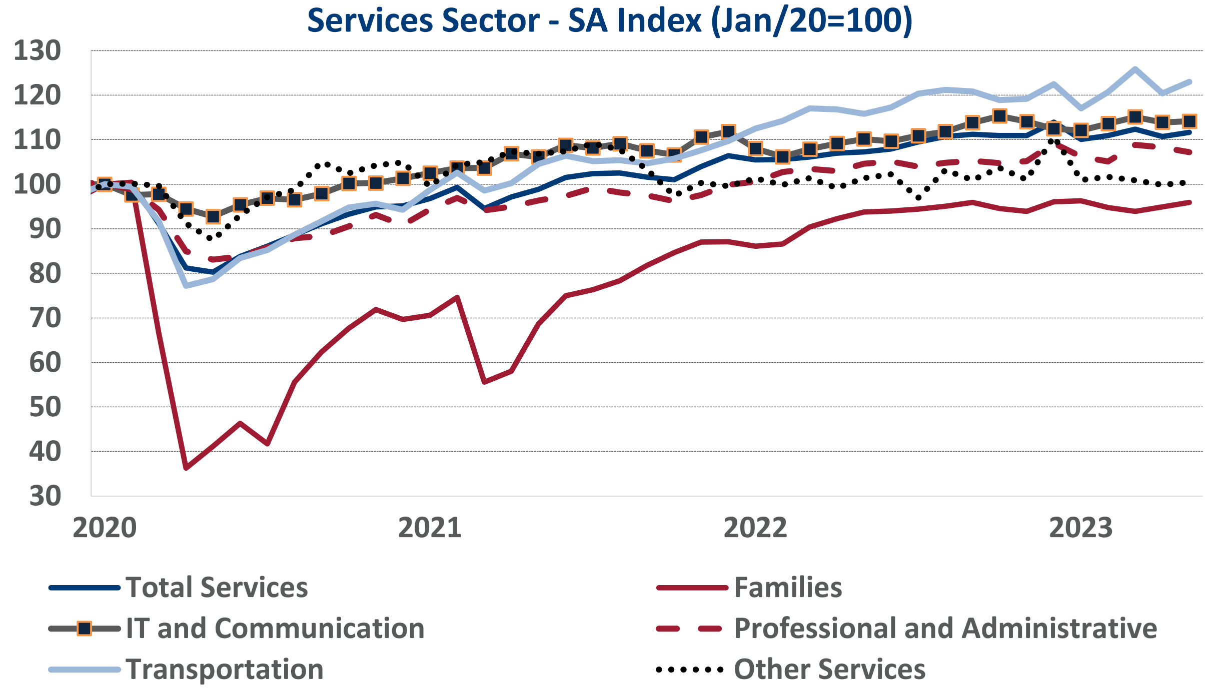


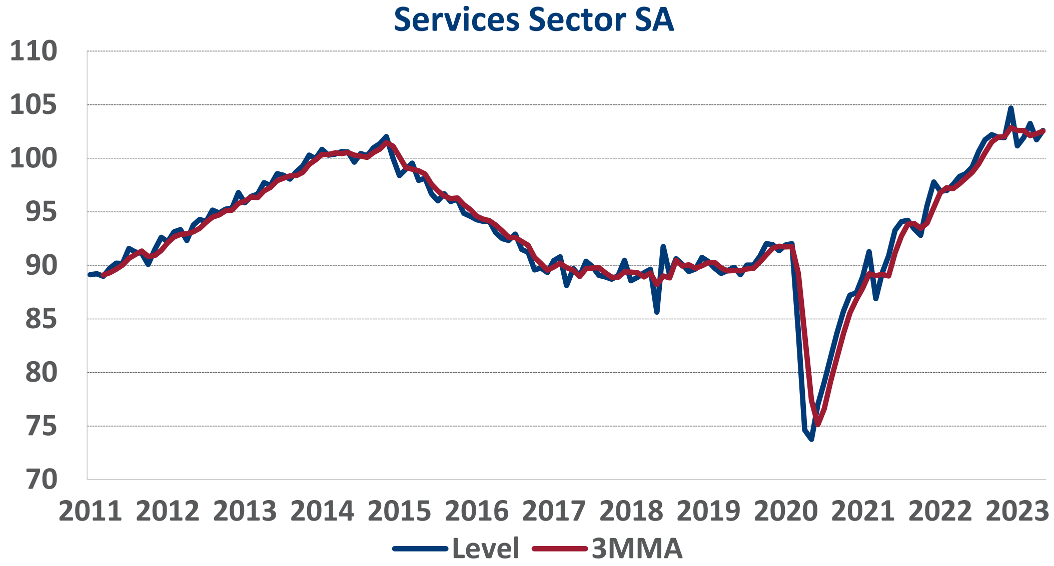


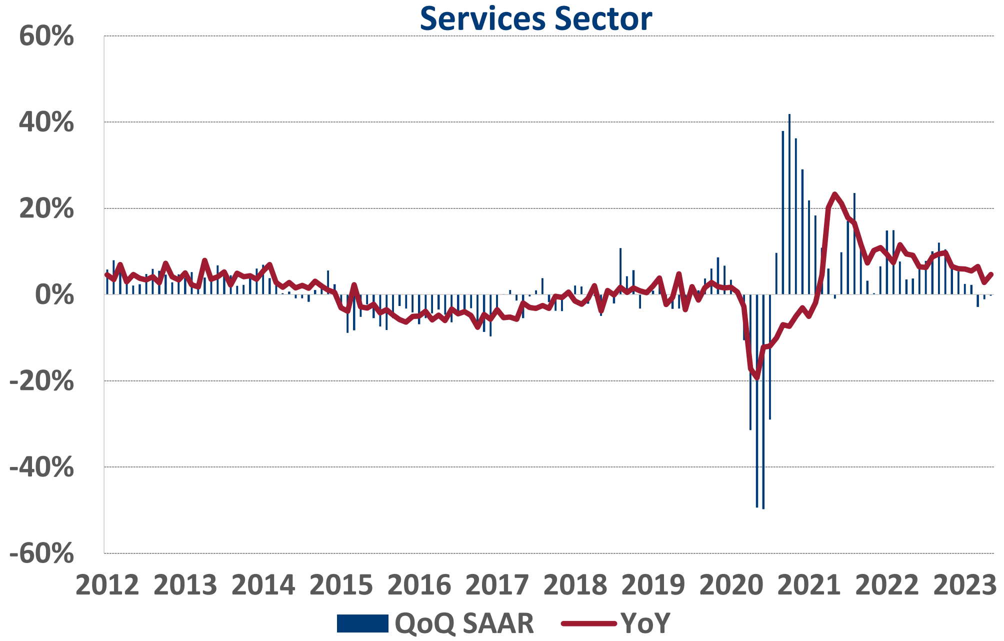
Source: IBGE, BOCOM BBM

Brazil: Services

- The services sector expanded 0.9% MoM, above expectations (0.4% MoM), a partial recovery from its drop in April (-1.6% MoM);
- Four out of five categories increased in May;
- The main positive contribution was ‘Transportation’ (+2.2% MoM), partially recovering from its performance in the previous month (-4.4% MoM);
- ‘Services to Families’ showed a 1.1% MoM increase, still owing to the enhancement in the personal income and the easing of short-term inflation.





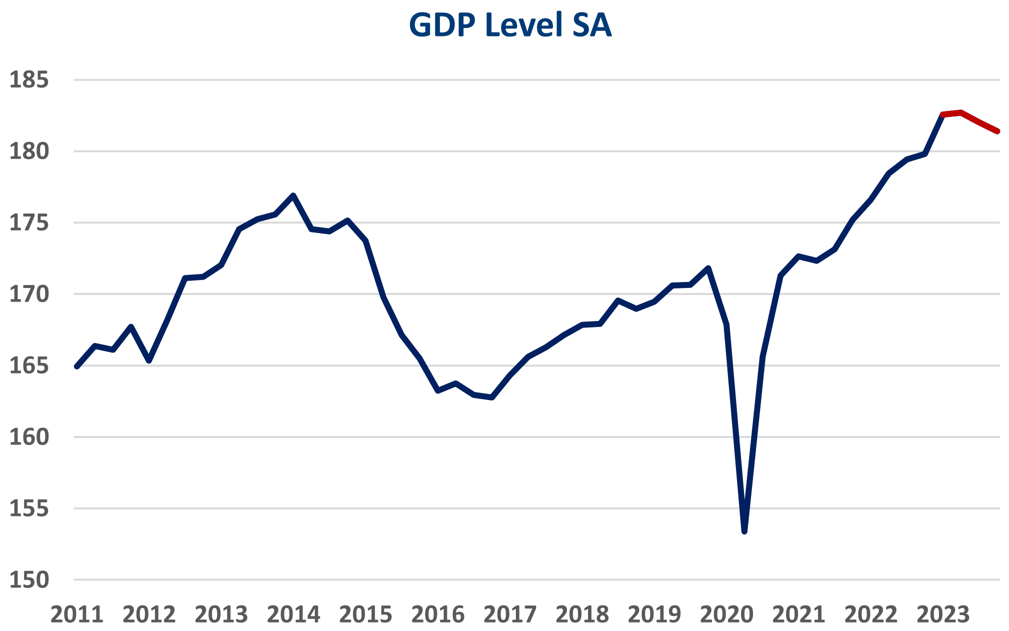


Source: IBGE, BOCOM BBM

Brazil: Economic Activity

- We revised our Q2 GDP forecast slightly upwards from 2.5% YoY to 2.6% YoY, up 0.3% QoQ in both cases;
  - We revised upwards the projections for the manufacturing and civil construction industries and some services such as retail and other services;
  - These increases were partially offset by lower projections in transportation, financial services and information and communication;
- Economic activity has gradually slowed down, given tight credit conditions and high household debt. However, the resilience of the labor market, greater government cash transfers and falling inflation have brought relief to activity in the short term.

	Q2 QoQ	Q2 YoY	2023
GDP	**0.3%**	**2.6%**	**2.0%**
Agriculture	**-2.0%**	**14.0%**	**12.0%**
Industry	**0.4%**	**0.9%**	**1.0%**
Mining	0.5%	6.5%	5.9%
Manufacturing	0.4%	-1.6%	-1.6%
Electricity	-0.3%	4.0%	4.4%
Civil Construction	0.2%	-0.4%	0.4%
Services	**0.3%**	**1.8%**	**1.3%**
Retail	0.5%	0.5%	0.2%
Transports	0.2%	2.2%	4.6%
Information and Communication	0.7%	3.8%	3.0%
Financial Services	0.1%	4.0%	2.3%
Rents	0.1%	2.0%	1.3%
Other Services	0.7%	2.0%	0.7%
Public Administration	0.4%	1.6%	1.4%



Source: BOCOM BBM, IBGE

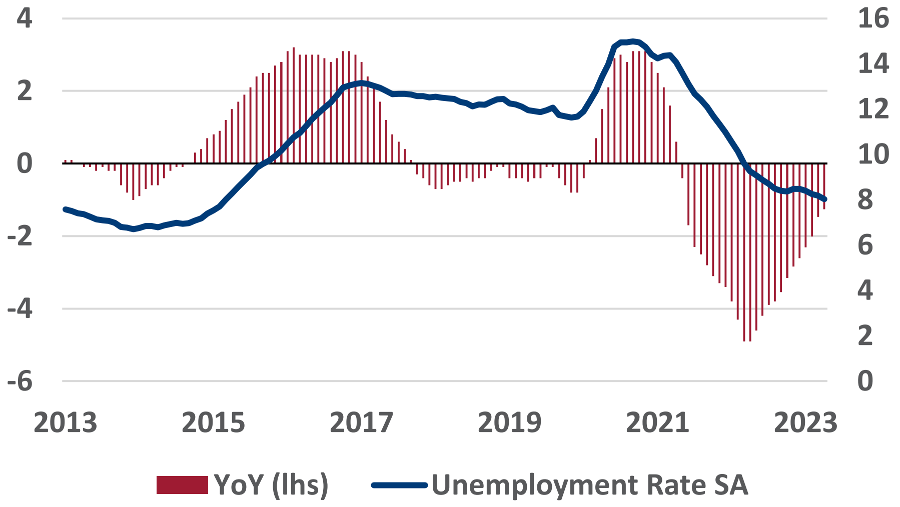
Brazil: PNAD

- The unemployment rate NSA reached 8.0% in May, below market expectations. Seasonally adjusted, the unemployment rate dropped from 8.15% in May to 8.0% in June;

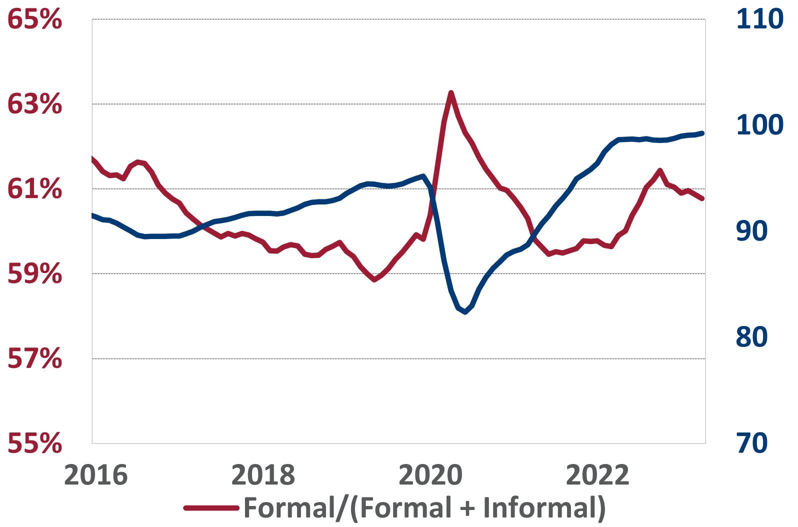
- The employed population grew by 0.14% MoM (the sixth consecutive positive variation), demonstrating that the sector remains resilient;

- The real labor earnings advanced 0.2% MoM in June, contrary to a decrease in May. Therefore, the real aggregate labor income continues to grow at the margin and is 7.2% above June 2022.

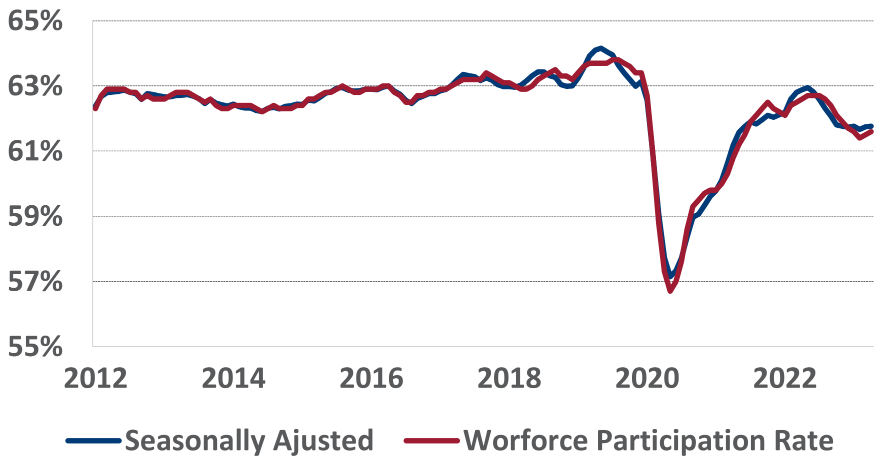
Brazil - Unemployment Rate



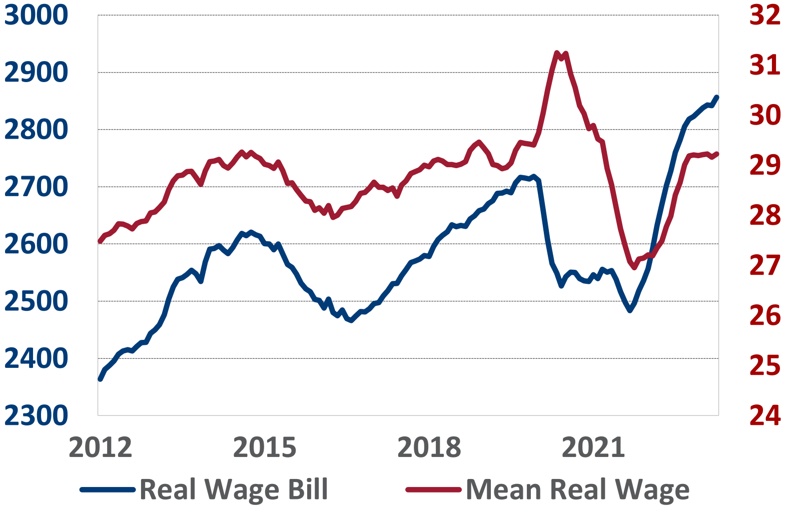
Brazil - Employment Level SA



Brazil - Workforce Participation



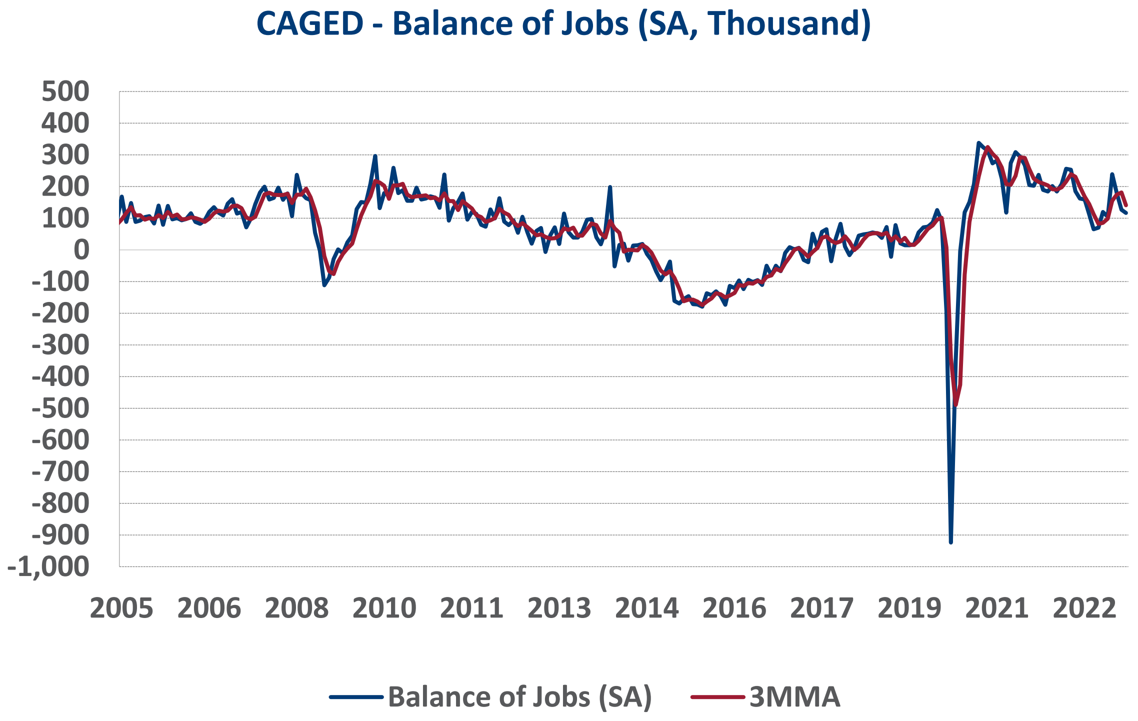
Brazil – Mean Real Wage and Real Wage Bill

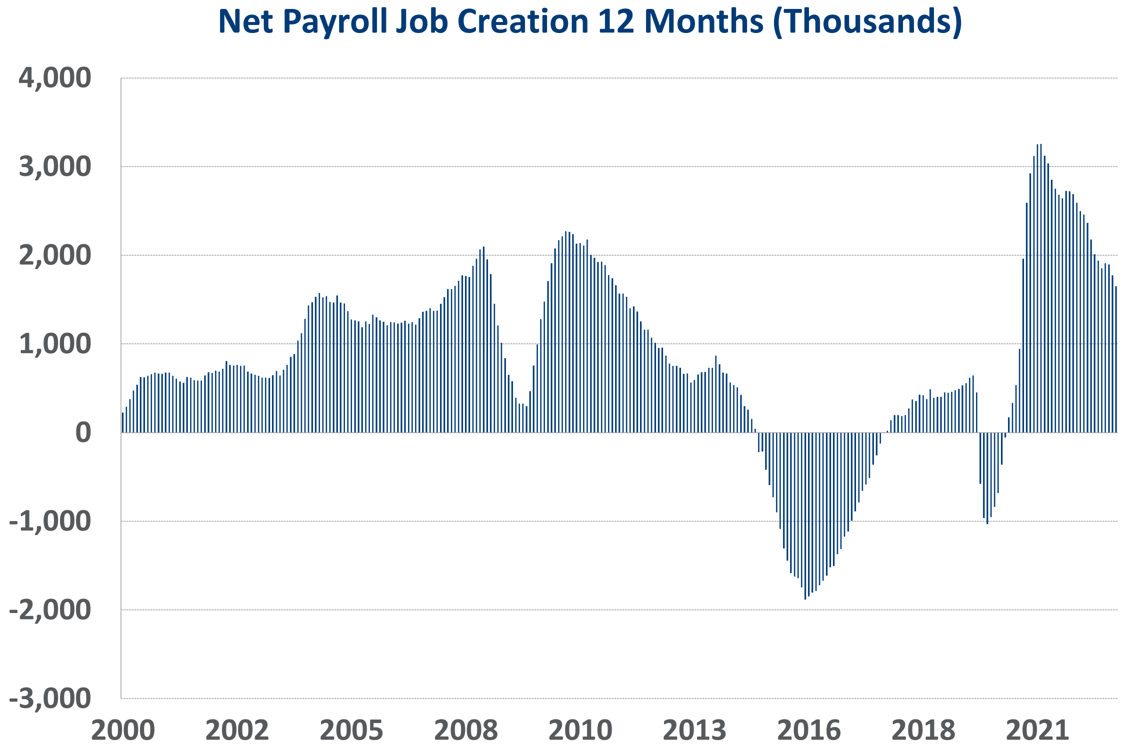


Source: IBGE, BOCOM BBM, MTE

Brazil: Formal Labor Market

- In June, Caged registered a net creation of 157.2k formal jobs, below market expectations (163.0k);
- The performance was above the historical average for the month (+122k), but below the one observed in June 2022 (+278k);
- Overall, we continue to see a gradual deceleration in formal employment throughout 2023.



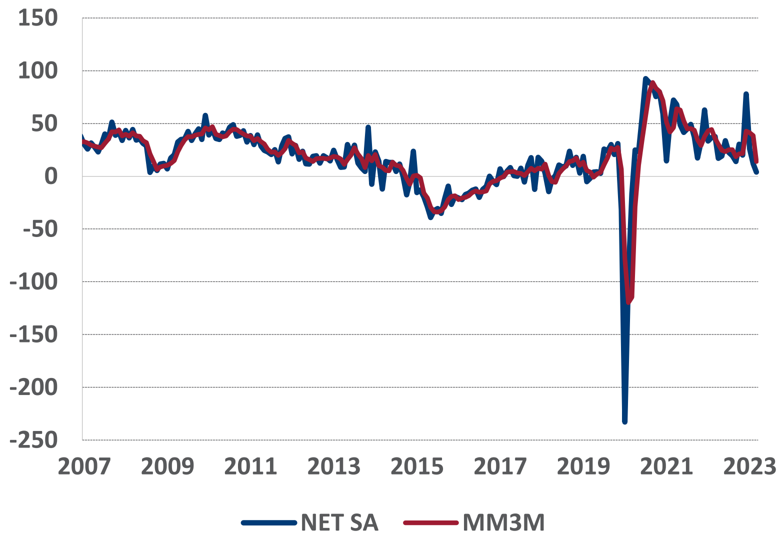


Source: BOCOM BBM, MTE

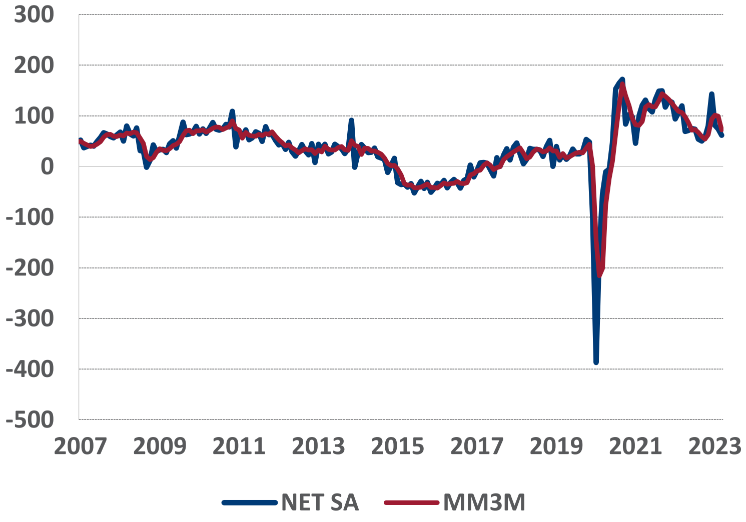
Brazil: Formal Labor Market

- The largest volume of jobs generated was in the service sector, with the record of net creation around 62 thousand jobs in June. On the other hand, civil construction, industry and commerce lost strength at the margin.

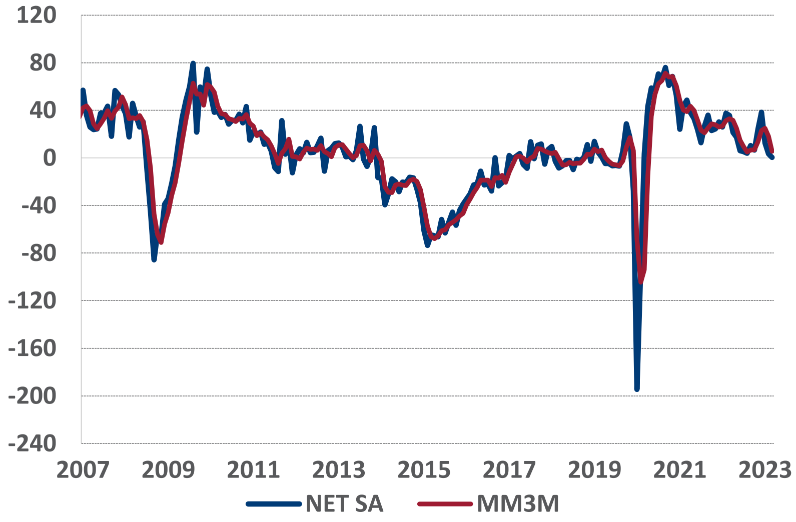
Brazil - Retail Net Payroll Job Creation (SA)



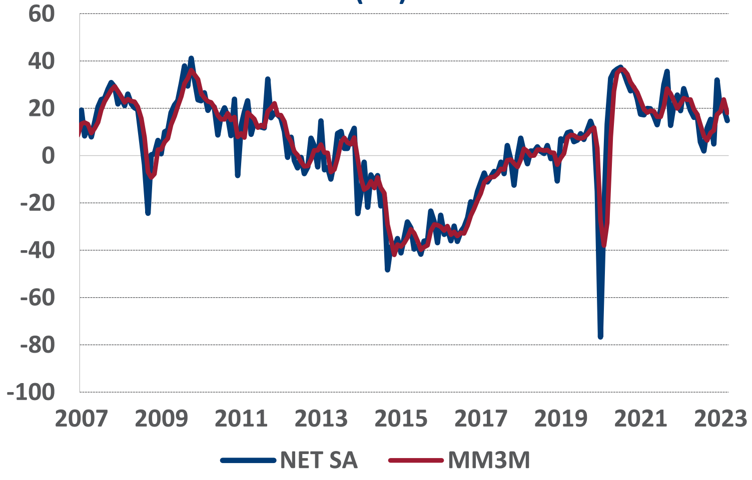
Brazil - Services Net Payroll Job Creation (SA)



Brazil - Industry Net Payroll Job Creation (SA)



Brazil - Construction Net Payroll Job Creation (SA)

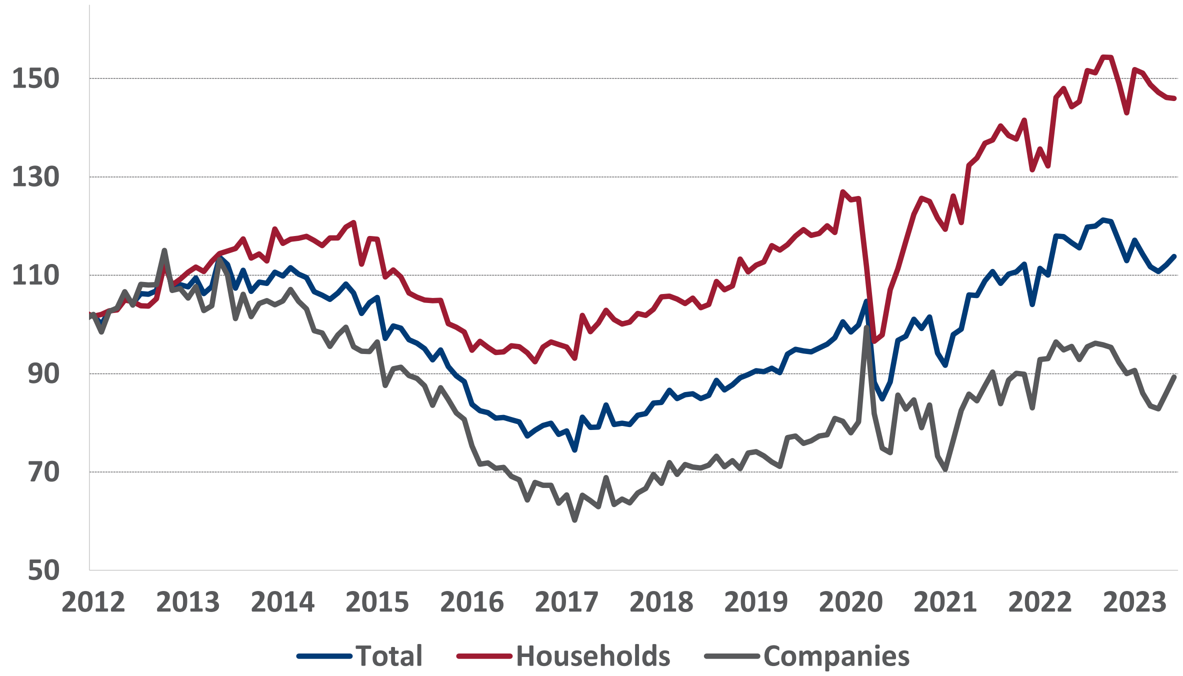


Source: BOCOM BBM, MTE

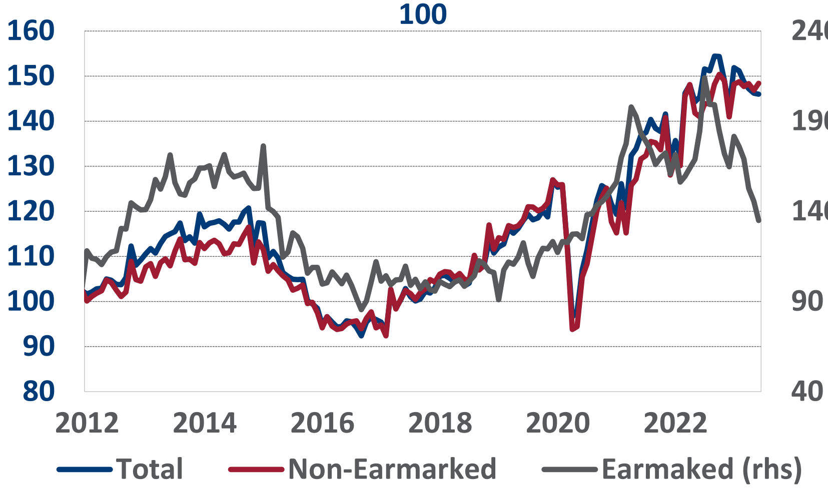
Brazil: Credit Statistics

- In June, total credit concessions grew 1.5% MoM in real terms;
- Non-earmarked credit concessions increased 1.1% MoM to households and to companies 7.0%;
- Corporate credit rebounded for the second consecutive month, after four consecutive monthly declines between January and April.

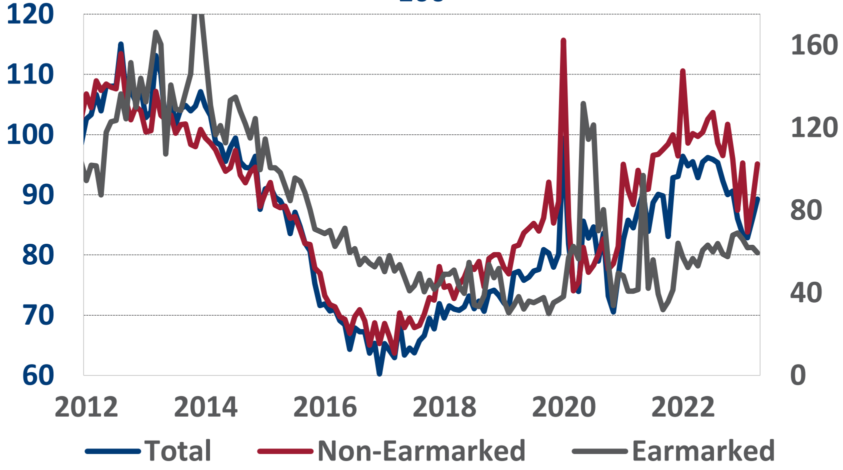
New Credit Operations SA (Real) - mar/11 = 100



Concessions - Households SA (Real) - Mar/11 = 100



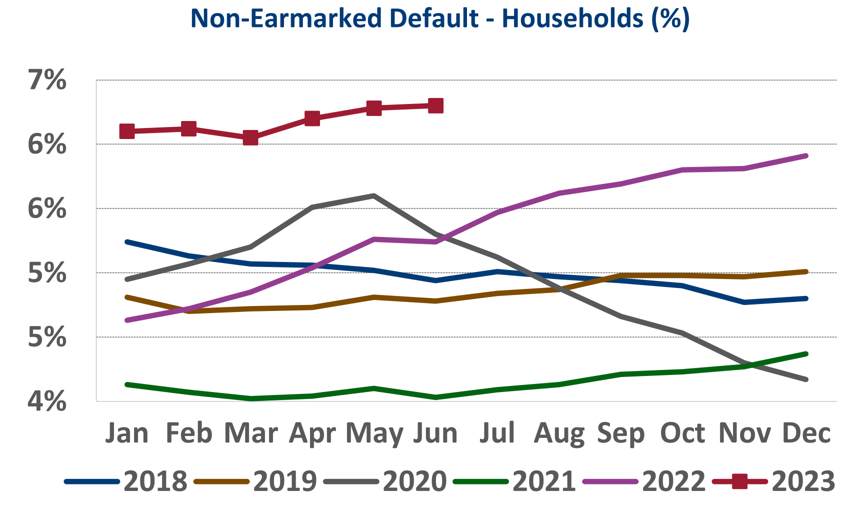
Concessions - Companies SA (Real) - mar/11 = 100

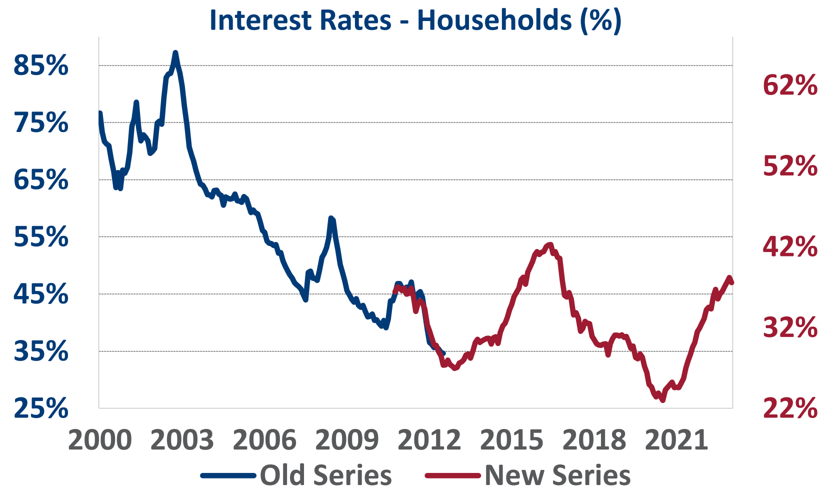


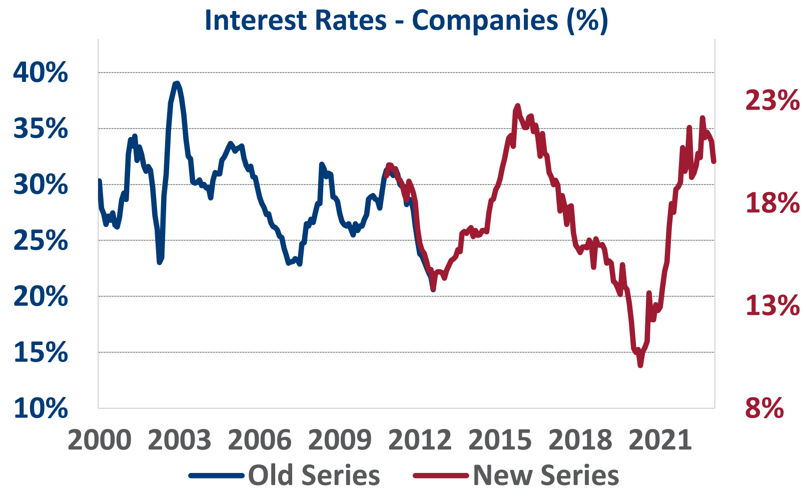
Source: BOCOM BBM, BCB

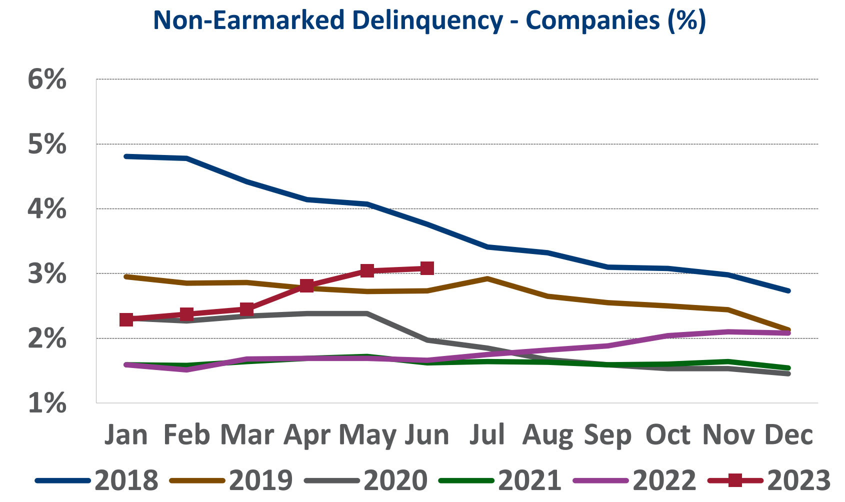
Brazil: Credit Statistics

- Lending rates to individuals fell modestly to 37.6%. To corporates, the lending rates were 20%;
- Non-earmarked default remained practically stable in June: 6.3% for individuals, the highest figure since 2016, and 3.08% for companies.





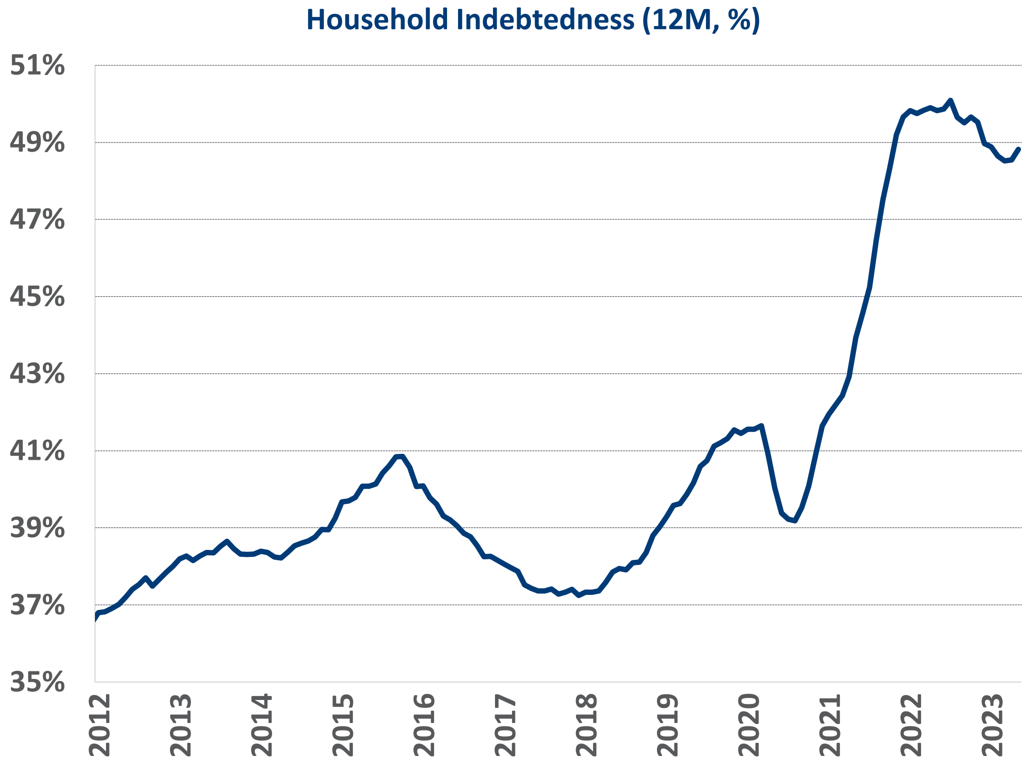


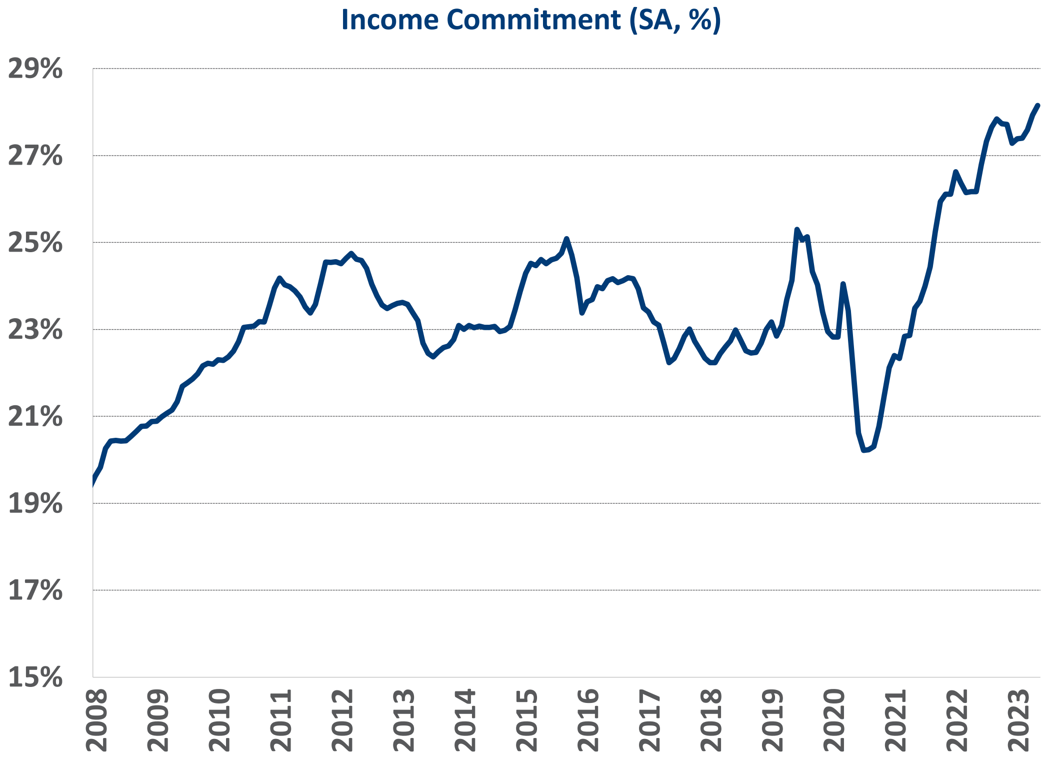


Source: BOCOM BBM, BCB

Brazil: Credit Statistics

- The household indebtedness indicator increased again (0.2 p.p.) to 48.8% in May;
- The income commitment, in turn, rose to 28.1%, the highest level of the historical series.





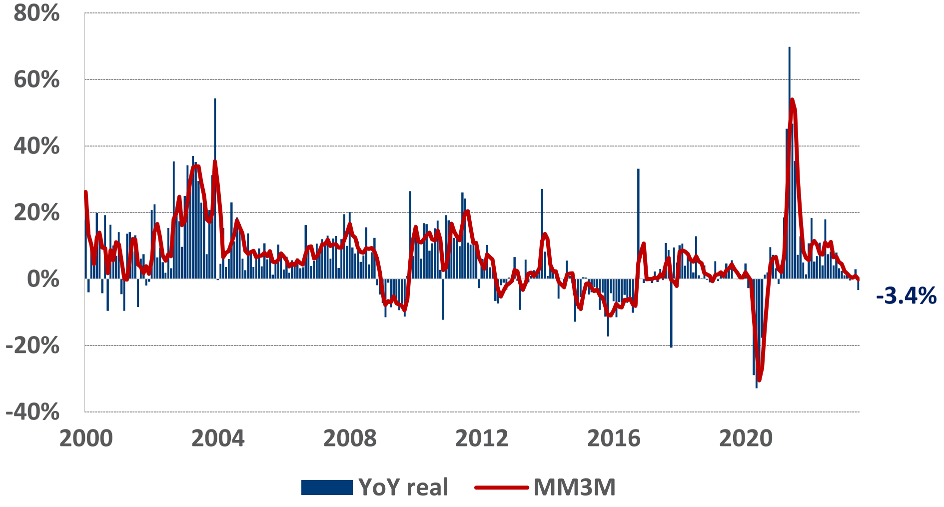
Source: BOCOM BBM, BCB

Brazil: Federal Tax Collections

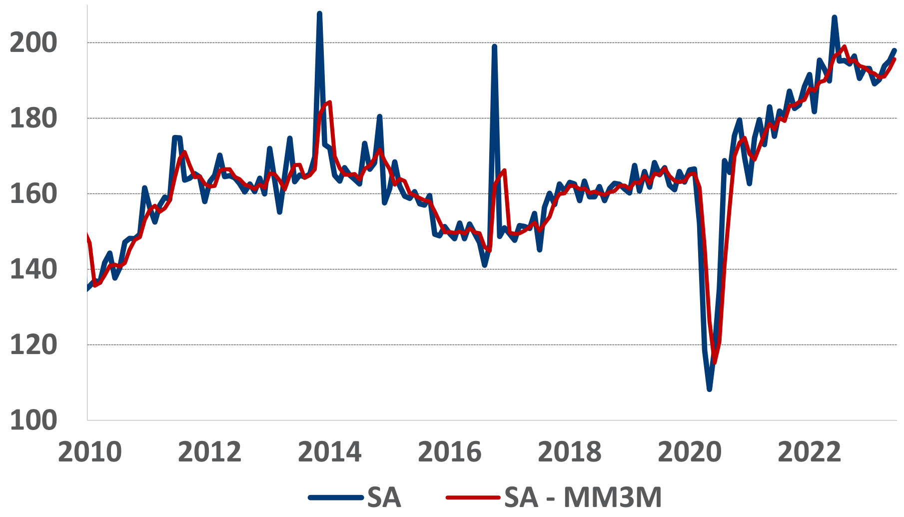
BANK OF COMMUNICATIONS 交通銀行 BBM

- Total federal tax collection reached BRL 180.5 billion in June, above expectations (BRL 179.5 billion), and represents a drop of 3.4% in real terms when compared to June 2022;
- The accumulated result in the year increased 0.3% YoY in real terms, reaching a historical record in the first half of the year;
- The main highlights of the month were social security contributions (+6.7%, owing to growth in the wage bill and tax offsets) and withholding income tax on capital gains (+10.8%, due to income from fixed income funds).

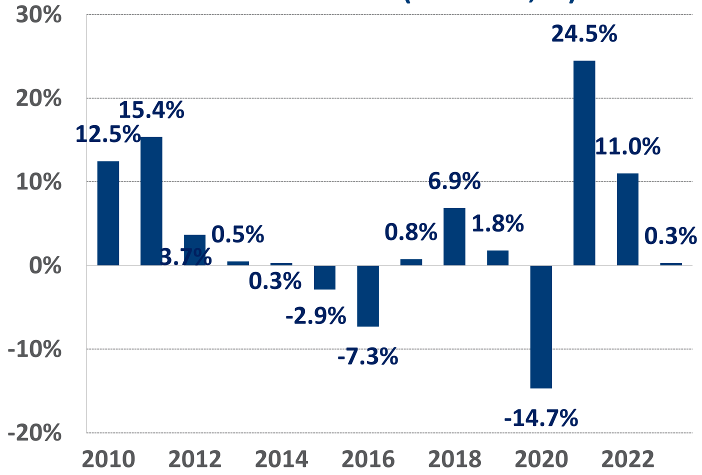
Arrecadação Federal (YoY Real, %)



Arrecadação Federal (R$ Bilhões, Real SA)



Total Tax Collection (YTD Real, %)



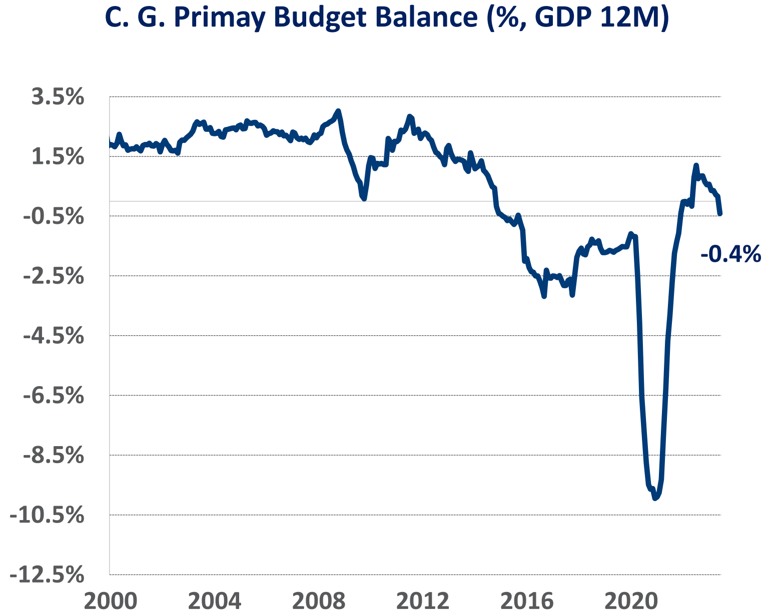
Total Tax Collection (% GDP)

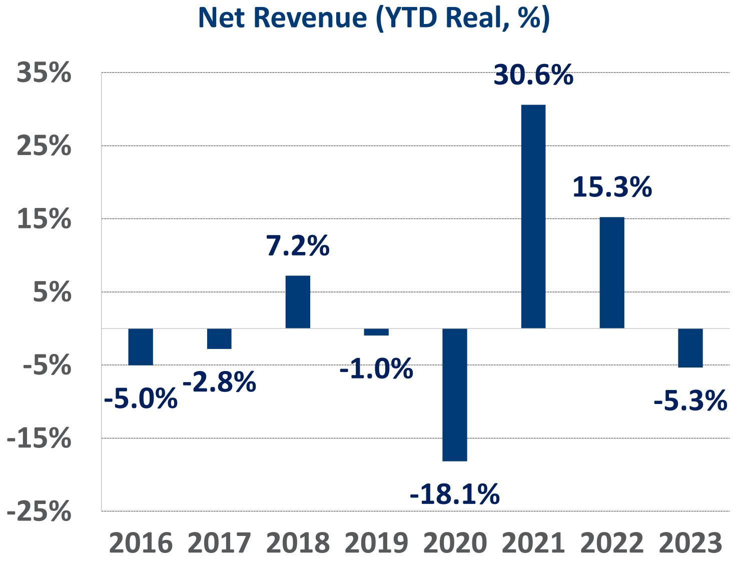
Fonte: BOCOM BBM, RFB

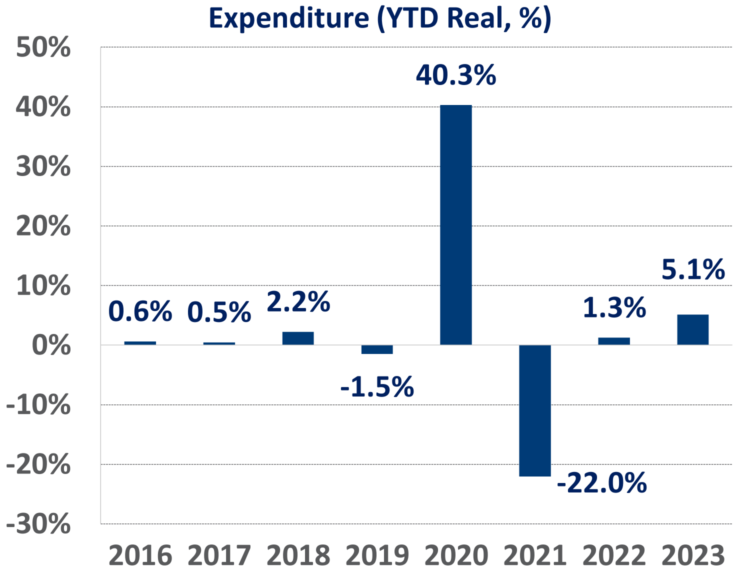
Brazil: Central Government Primary Result

交通銀行 BANK OF COMMUNICATIONS BBM

- In June, central government's primary balance posted a deficit of BRL 45.2 bn, above the market expectations (BRL -44.7 billion);
- In the 12-months the Central government's primary balance accumulated a deficit of BRL 41.5 billion (0.4% of GDP);
- The net revenue fell 26.1% in real terms compared to June 2022, with emphasis on tax revenues (-4.9%). Non-tax revenues also dropped (-68.8%), due to the decrease in the flow of concessions (-94.9%) and dividends (-80.9%). On the positive side, social security revenue rose by 8.4% due to an increase in payroll;
- Total spending surged 4.9% YoY in real terms. The main drivers were a rise in pensions and retirees' benefits (13.4%), and the rise in unemployment insurance and wage bonus (13.4%), explained by a change in the disbursements' calendar and in the Bolsa Família program (95.4%).







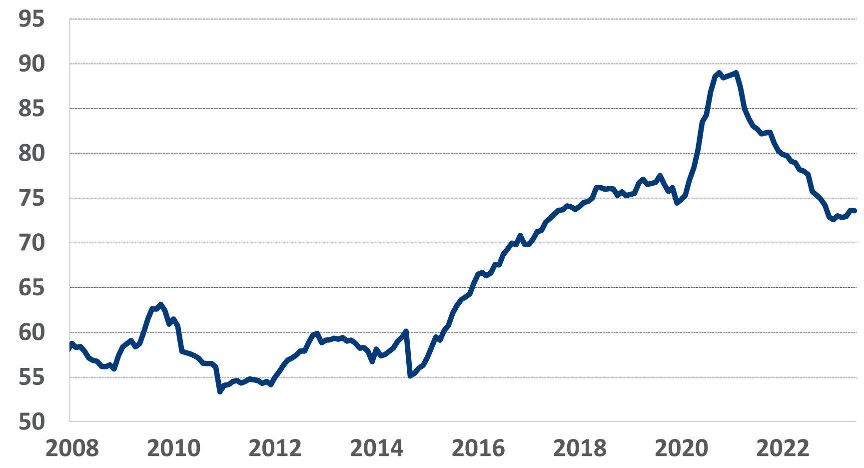
Source: BOCOM BBM, RTN

Brazil: Consolidated Public Sector Budget

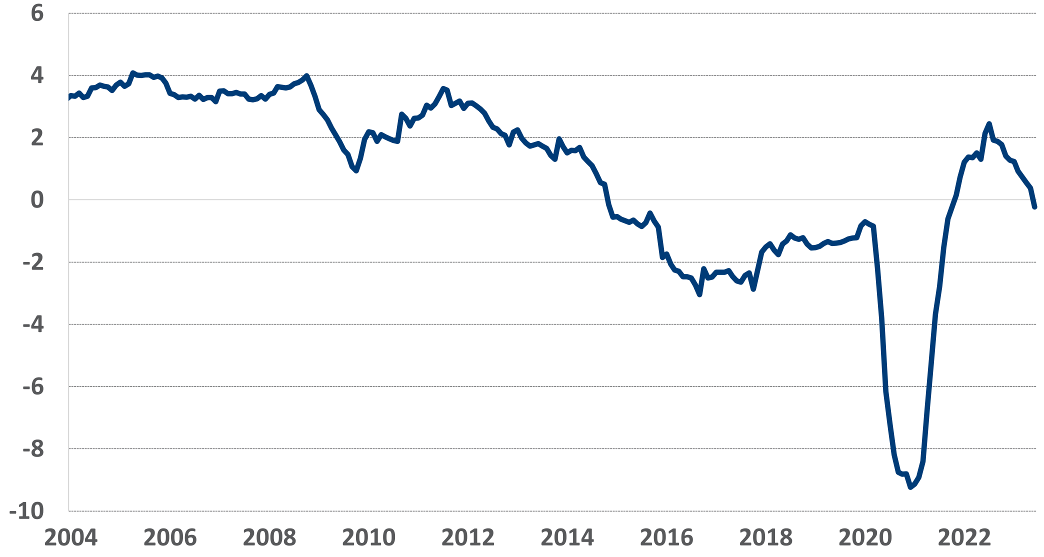
- The consolidated public sector recorded a primary deficit of BRL 48.9 billion in June, with the central government registering a deficit of BRL 46.5 billion, subnational governments a deficit of BRL 0.9 billion and state-owned companies reaching a deficit of BRL 1.5 billion – the first deficit after 19 months of surplus;

- Gross General Government Debt remained unchanged at 73.6% in June. The positive contribution from 'Interest Settlement' (0.6 pp. of GDP) was offset by net issuance (-0.1 pp.), exchange rate appreciation (-0.2 pp.) and nominal GDP growth (-0.3 pp.).

Gross General Government Debt (% GDP)

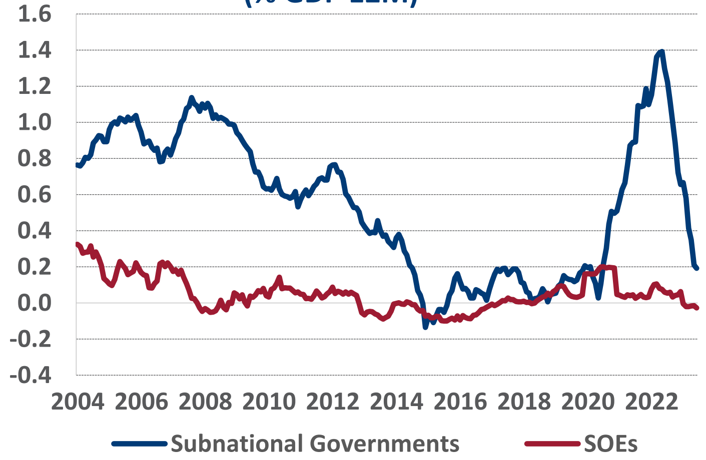


Primary Budget Balance (% GDP 12M)



Primary Surplus: Central Government (% GDP 12M)

Primary Surplus: Subnational governments and SOEs (% GDP 12M)



Source: BOCOM BBM, BCB

Brazil: Tax Reform, Lower House Version

- On July 7th, the Tax Reform Proposal (PEC 45) was approved by the Lower House. Although it must still pass the Senate, the decision represents a step forward towards modernizing the Brazilian tax system;

- The text replaces the current five taxes (IPI, PIS, Cofins, ICMS and ISS) by Dual VAT System which consists in a federal tax (called CBS) and a States and Municipalities Tax (called IBS). This Dual-VAT System will be applied to all goods and services (including digital), collected at the destination, will be a full non-cumulative tax system (that allows the credit compensating of previously paid taxes on all inputs utilized in the production stages) and allows limited exemptions or reduced rates;

    - Its implementation will reduce complexity, produce transparency, eliminate distortions, end “tax war” between states, increase competitiveness and reduce social injustice;

- Three types of charges will be assigned: the standard rate, a 60% reduction in rates for specific goods and services (agricultural production and healthcare, for example) and the zero rate, which may apply to some medications (such as to treat cancer) and public transport;

- The system transition for taxpayers will take 8 years, starting in 2026, but for States and Municipalities it will take 50 years from 2029;

- It also provides for a Regional Development Fund, as it aims to reduce regional inequalities and promote economic growth and a Tax Benefit Compensation Fund, which will be used to offset losses with ICMS tax benefits between 2029 and 2032;

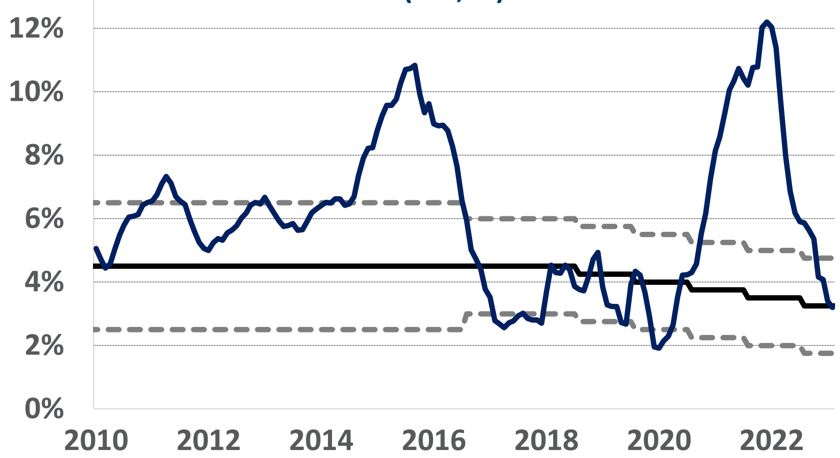
    - Both funds will be financed by the Union reaching a total amount of BRL 40 bn in 2033. However, the funds do not change the fiscal framework, since studies points to potential GDP gains that should overlap their fiscal cost.

Source: BOCOM BBM

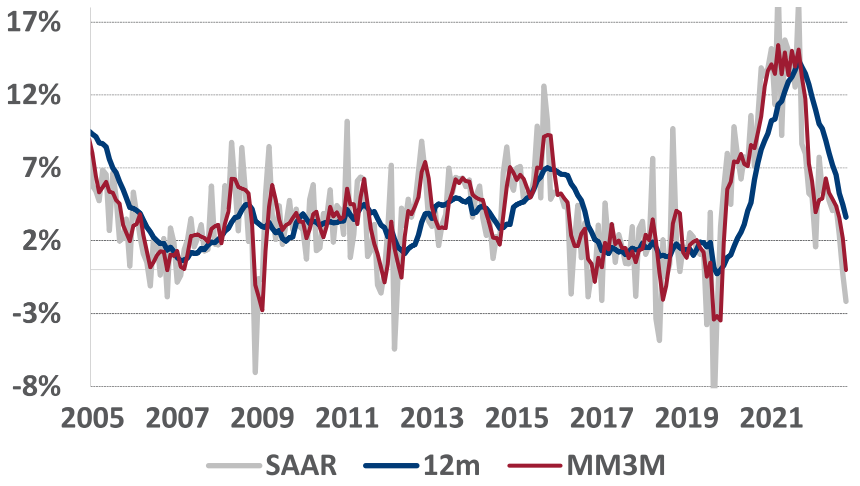
Brazil: Inflation 2023

- The July IPCA preview fell by 0.07% MoM, below market consensus of -0.03% MoM
- The variation in 12 months retreated to 3.2% in July, compared to 3.4% in June;
- The negative figure results in part from transitory effects such as vehicle price subsidies and a temporary reduction in electricity tariffs, along with the sharp deflationary dynamics for food;
- The average of core inflation retreated to 0.09% in July and the 3-month moving average of the seasonally adjusted annualized data retreated from 5.0% in June to 3.8% in July, a significant relief;
- Underlying services advanced 0.35% MoM, below expectations, after a less benign figure in June. The services diffusion also fell sharply, from 54% in June to 44% in July.

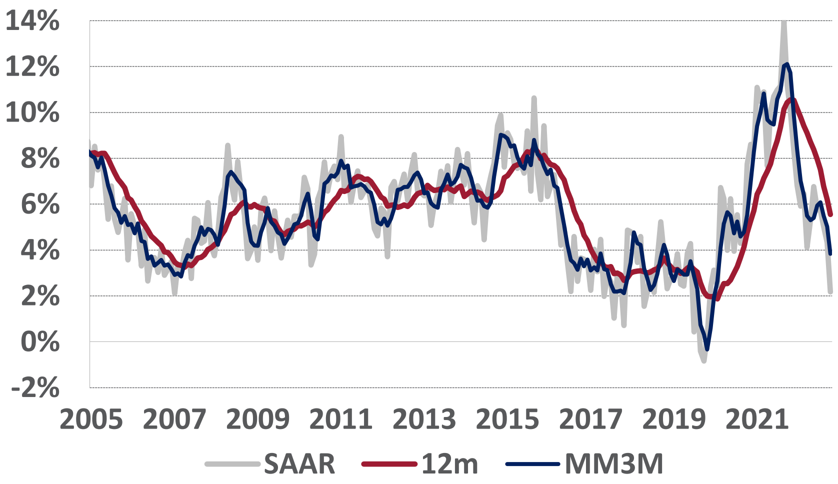
IPCA (YoY, %)



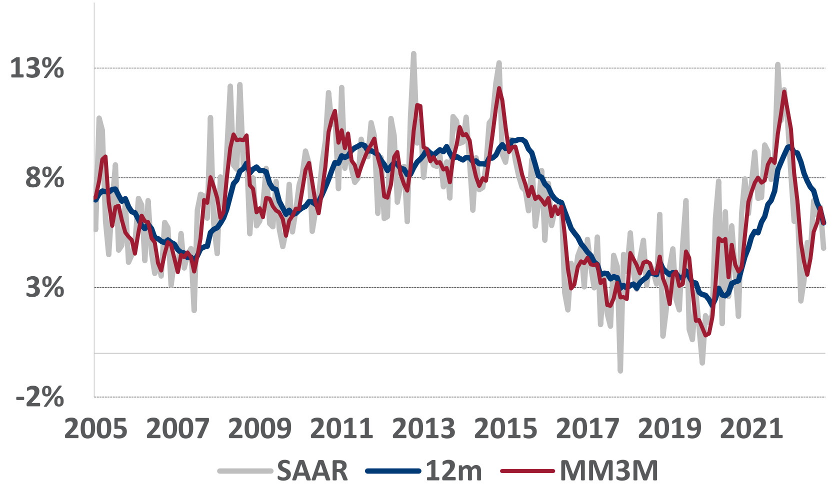
Industrial Goods



Average of Cores



Core Services

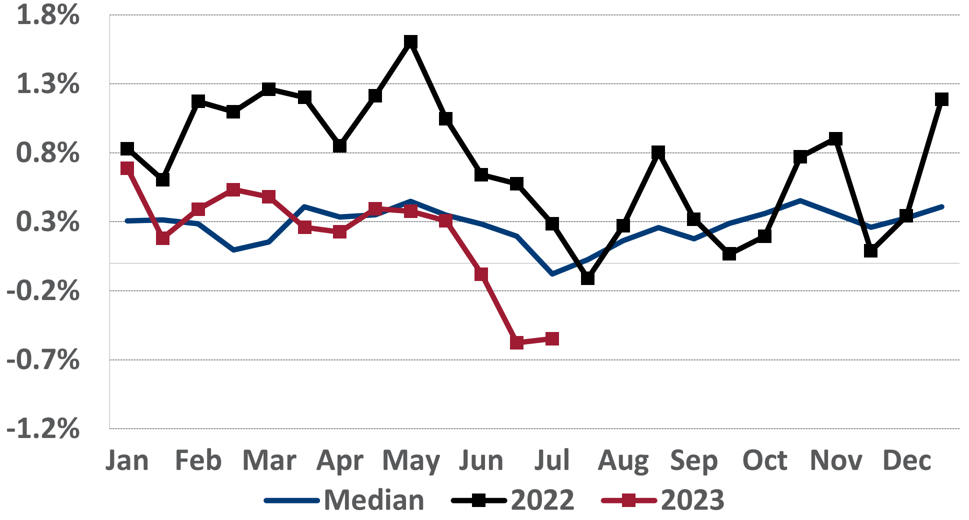


Source: BOCOM BBM, IBGE

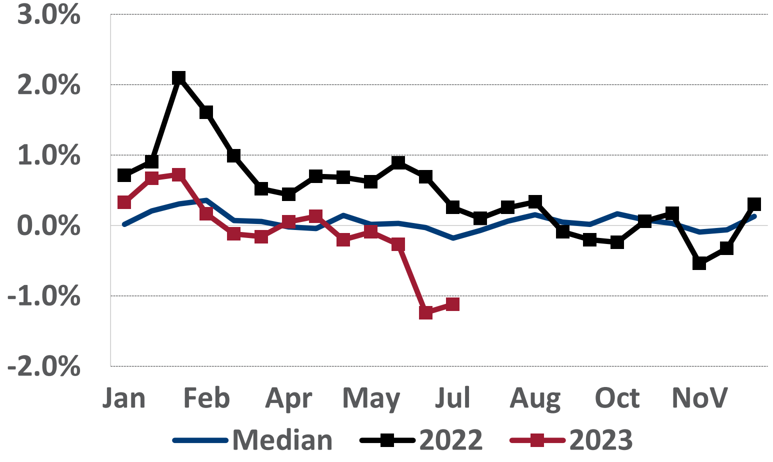
Brazil: Inflation 2023

- Industrial goods decelerated to -0.55% in July from -0.08% in June, driven by durable and non-durable goods.

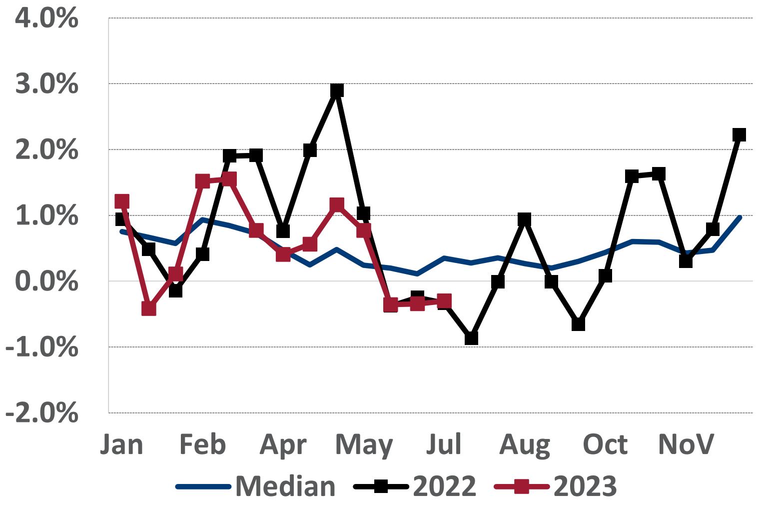
Industrial Goods (MoM, %)



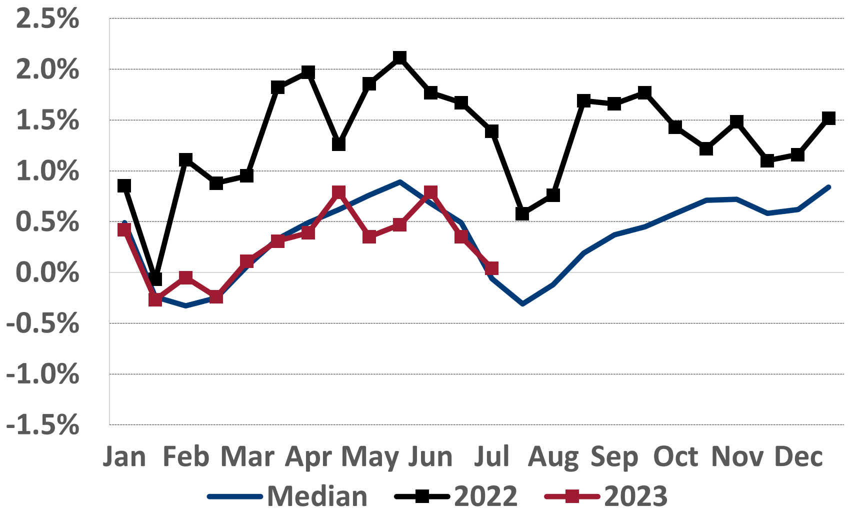
Durable Goods (MoM, %)



Non-Durable Goods (MoM, %)



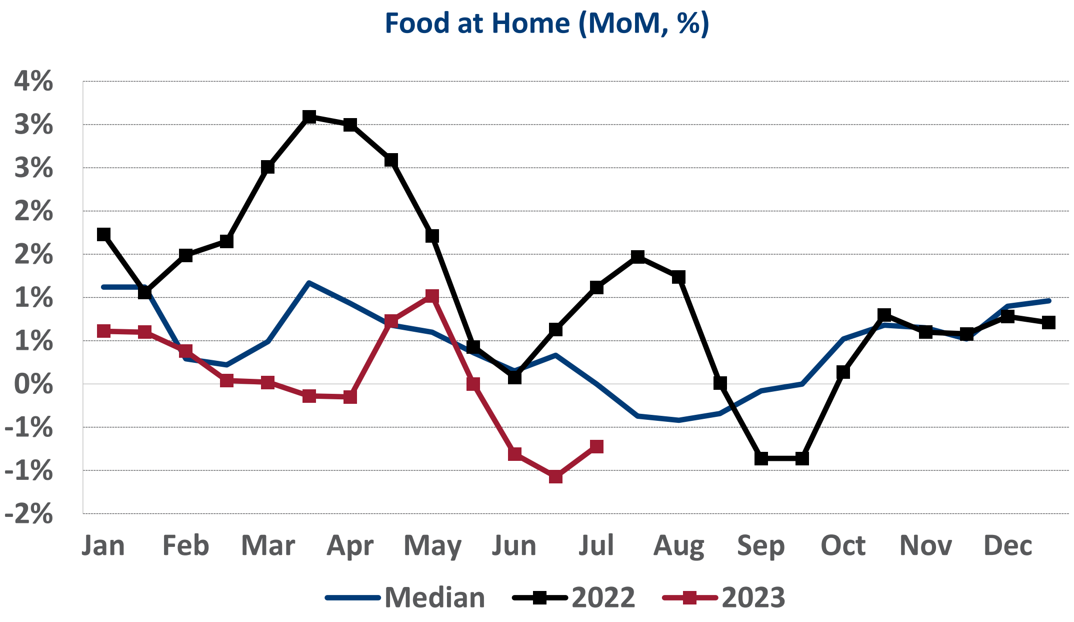
Apparel (MoM, %)

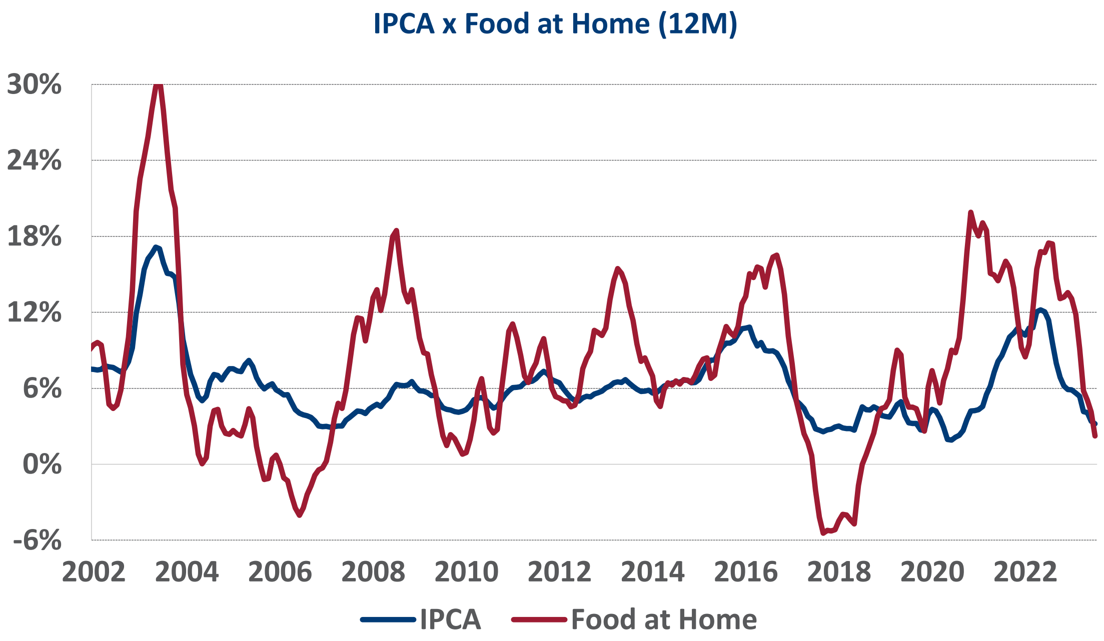


Source: BOCOM BBM, IBGE

Brazil: Inflation 2023

- Food at home inflation fell -0.72%, reaching 2.2% in 12 months (last year it was close to 17% YoY);
- This category has benefited from deflations in grains, meat, chicken, and milk;
- A record harvest combined with the moderation on commodity prices is contributing to the food inflation this year.





Source: BOCOM BBM, IBGE

Brazil: Inflation

» Our projection for the year 2023 is 4.8%. After the July IPCA preview, we revised downwards services, industrials and food, which were offset by the increase in regulated prices, that is, a better composition. For 2024, we maintain our forecast at 3.6%.

IPCA (%, annual)

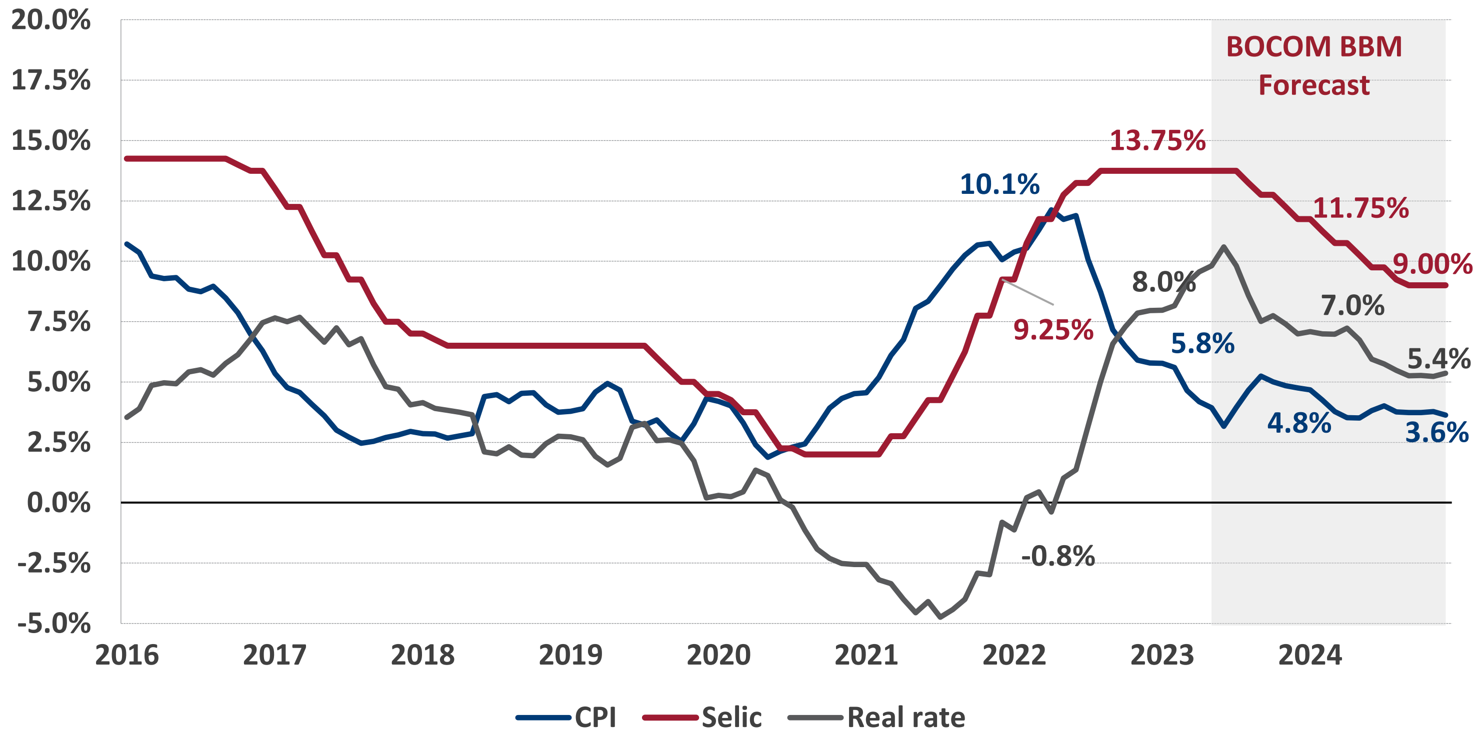
	Weight	2019	2020	2021	2022	2023	2024
Regulated	**26.6**	**5.5**	**2.6**	**16.9**	**-3.8**	**9.0**	**4.0**
Industrial goods	**23.6**	**1.7**	**3.2**	**11.9**	**9.5**	**2.0**	**2.2**
Durable goods	10.3	0.0	4.5	12.9	6.1	-0.4	-
Semi-durable goods	5.9	0.6	-0.1	10.2	15.7	2.9	-
Non-durable goods	7.3	4.4	4.0	11.9	9.5	4.5	-
Food at home	**15.7**	**7.8**	**18.2**	**8.2**	**13.2**	**0.0**	**2.8**
Services	**34.1**	**3.5**	**1.7**	**4.8**	**7.6**	**5.7**	**4.7**
Food away from home	5.6	3.8	4.8	7.2	7.5	5.9	4.5
Related to minimum wage	5.2	2.9	1.5	3.3	6.3	4.7	5.9
Sensitive to economic activity	8.2	2.4	0.2	5.1	6.3	7.2	4.8
Inertial	15.0	4.3	1.6	4.2	8.8	5.2	4.3
IPCA		**4.3**	**4.5**	**10.1**	**5.8**	**4.8**	**3.6**

Source: BOCOM BBM, IBGE

Brazil: Monetary Policy

- At the August meeting, the BCB decided to cut Selic rates by 50 bps, reaching 13.25% per year. 4 members voted for a 25bps cut, while 5 members voted for a 50bps cut
- The Central Bank projections indicate that rates reaching 12% by 2023 and 9.25% by 2024 would bring inflation to 4,9% in 2023, 3,4% in 2024 and 3% in 2025. As 2025 enters the relevant horizon, this decision is consistent with bringing inflation to around the target of 3%
- The easing cycle still requires “serenity” and “moderation”, and the committee foresees other cuts of the same magnitude (50 bps) in the following meetings if the economic scenario turns out as expected. The decision and communication came in line with our expectations, so we maintain the scenario of a terminal interest rate of 11.75% by the end of 2023 and 9% in 2024;

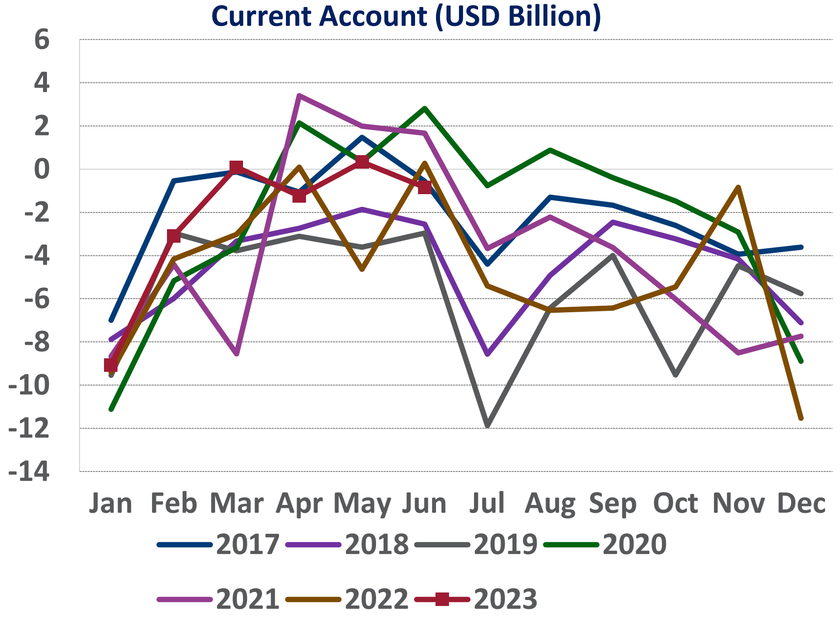
CPI, Selic Rate and Real Ex-post Interest Rate (YoY, %)

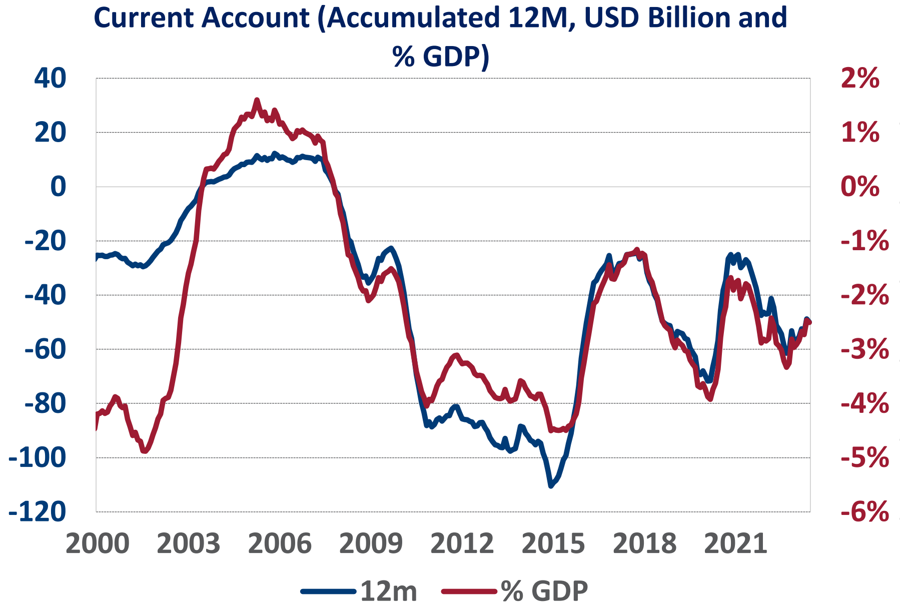


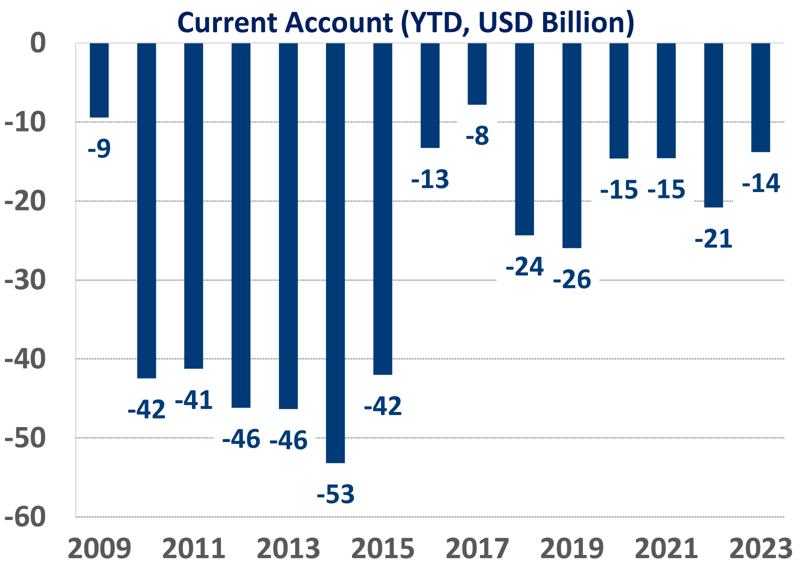
Source: BCB, BOCOM BBM, IBGE

Brazil: Balance of Payments

- The Brazilian current account registered a deficit of US$0.80 billion in June (Consensus: +US$1.0 billion), below the surplus of US$0.3 billion recorded in June 2022;
- The current account balance was US$ -50.0 billion in the accumulated 12 months through June (-2.50% of GDP).



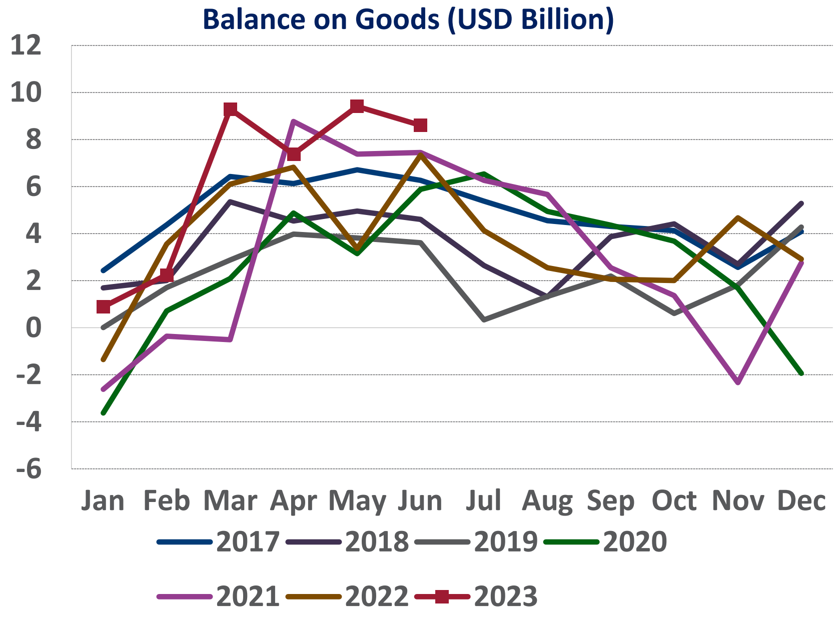


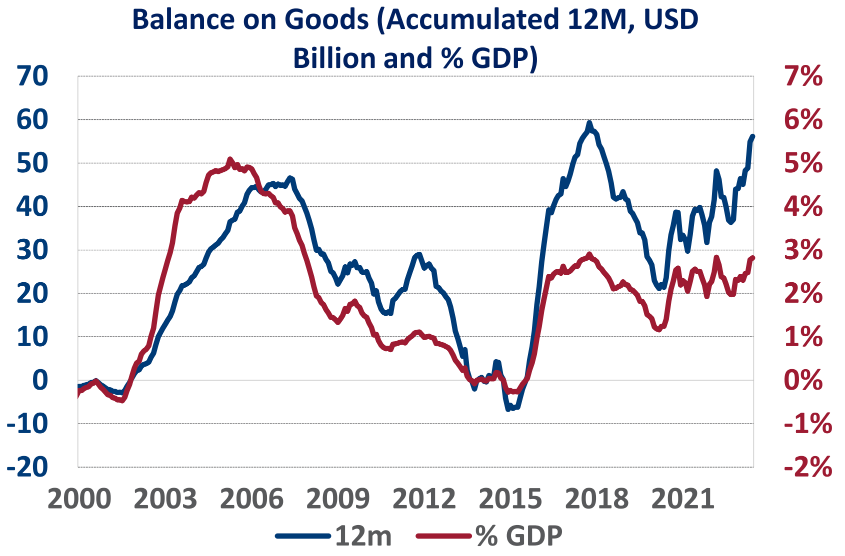


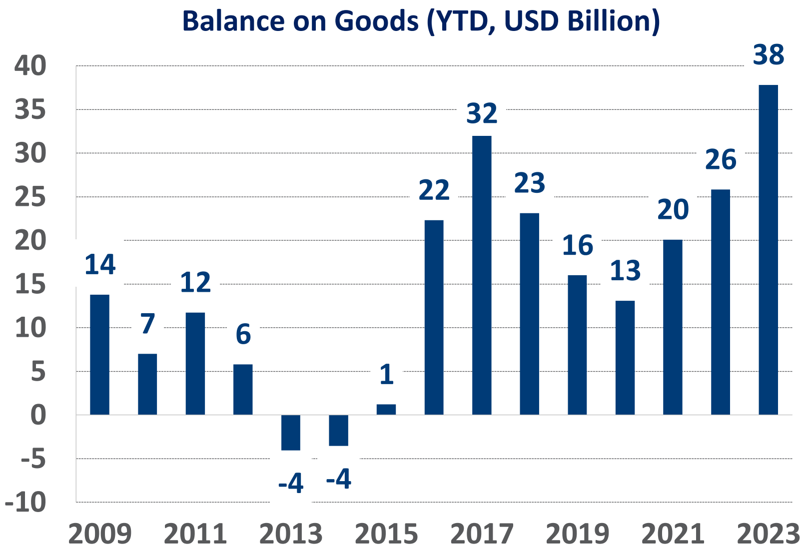
Source: BOCOM BBM, BCB

Brazil: Balance of Payments

- On the positive side, the merchandise trade balance showed a surplus of USD 8.6 billion in June, totaling USD 56.1 billion in the accumulated 12 months, above the result of May (USD 54.9 billion);
- Exports increased by 1.8% YoY from January to June 2023 (10.1% in 12 months), while Imports tumbled 6.4% YoY in the same period (+6.5% in 12 months);
- The performance of ‘Imports’ reflects the slowdown in domestic demand, meanwhile the external demand for primary goods remains firm.







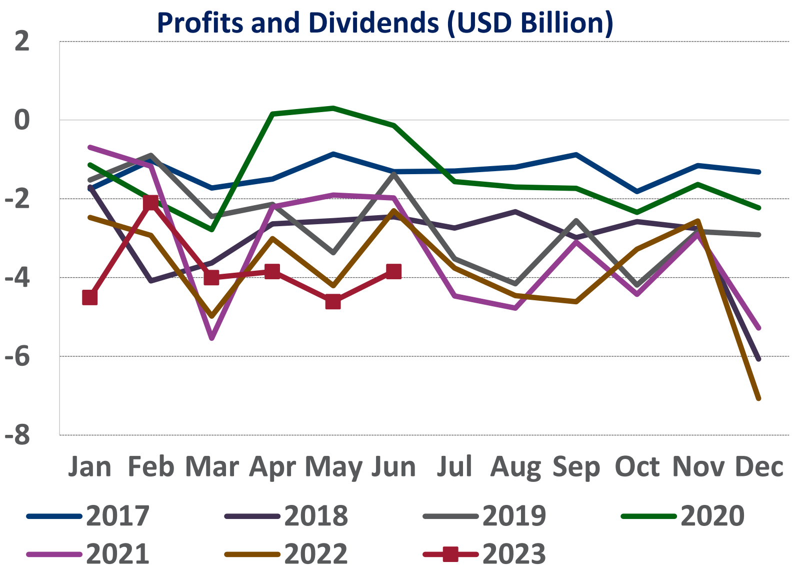
Source: BOCOM BBM, BCB

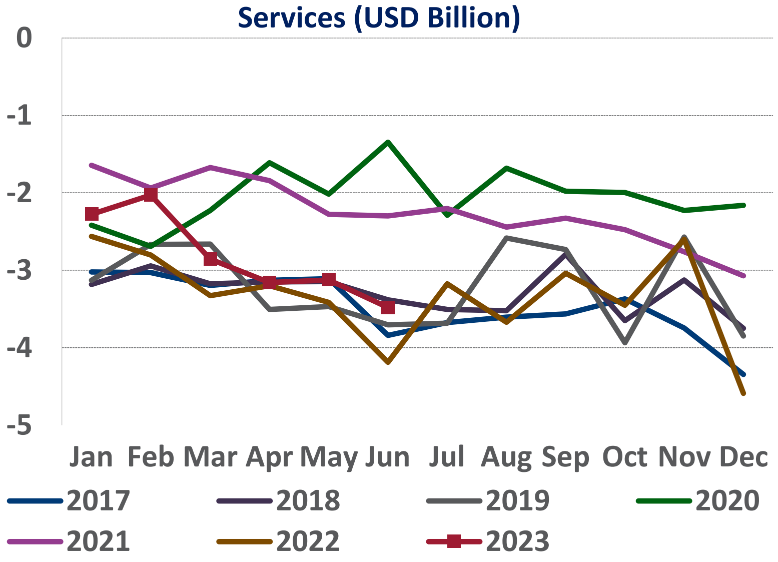
Brazil: Balance of Payments

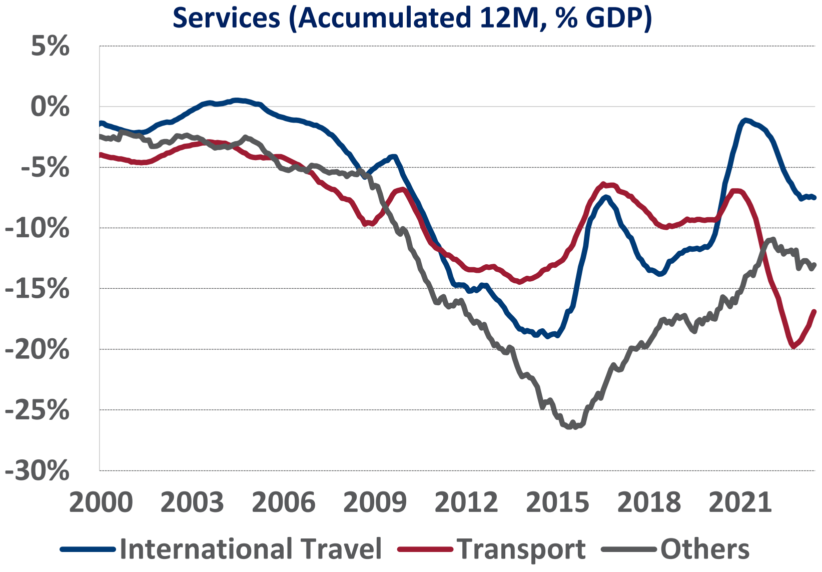
- On the negative side, the deficit in the Primary Income account (US$ -6.2 billion in June 2023 compared to US$ -3.4 billion in June 2022) explains the negative surprise in the current account;

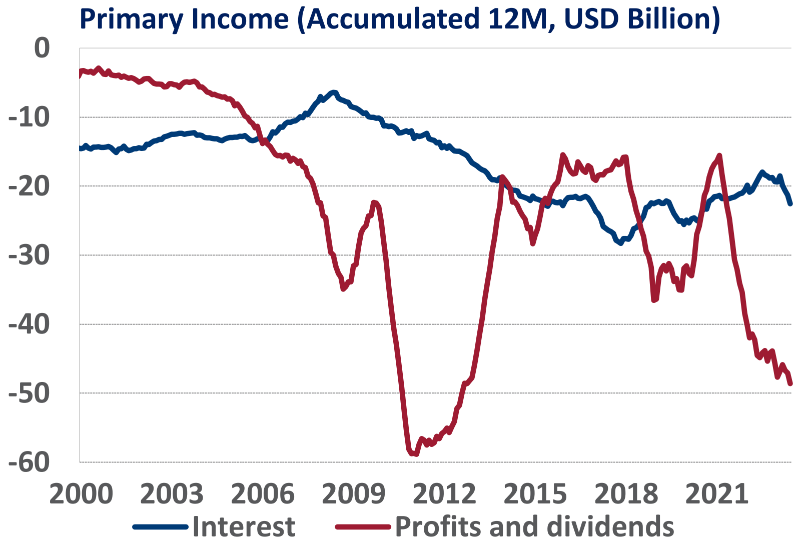
- It was mainly due to higher net expenses with profits, dividends and interest rates, which is a result of higher gross expenses on intercompany transactions and rising international interest rates;

- The deficit in the Services account dropped on a yearly basis (USD -3.5 billion from USD -4.2 billion), owing to lower expenses with freight.







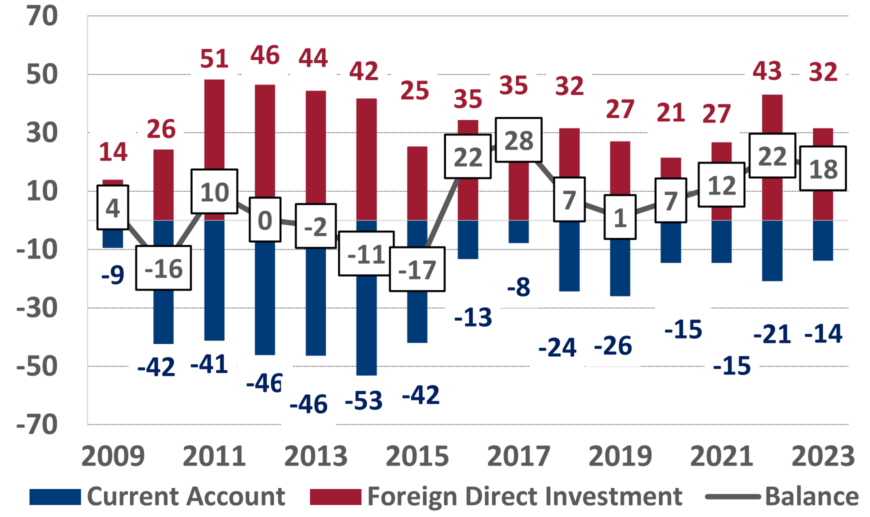


Source: BOCOM BBM, BCB

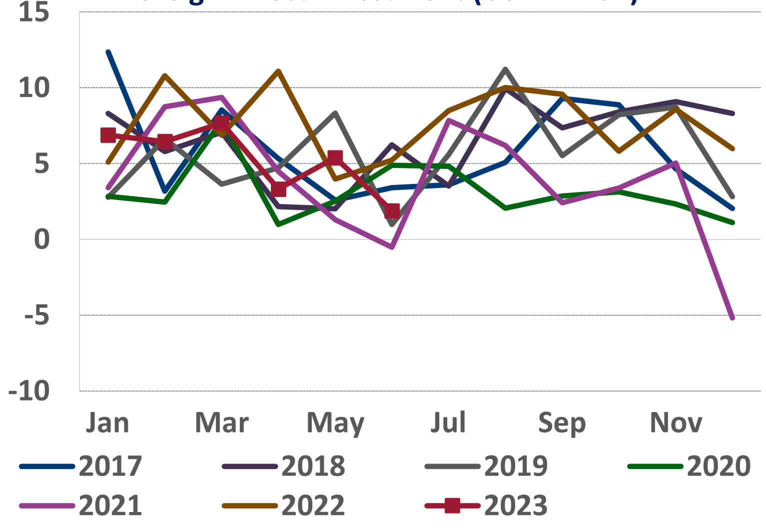
Brazil: Balance of Payments

- Net inflows of FDI (Foreign Direct Investment) amounted to US$ 1.9 billion in June, significantly below expectations (US$ 6.8 billion) and the amount of US$ 5.2 billion registered a year earlier;
- The result is mainly due to net outflows of US$ 1.8 billion in intercompany transactions;
- FDI totaled US$80 billion on a 12-month rolling sum basis through June (4.01% of GDP), down from US$83.4 billion through May (4.21% of GDP), but better than the result seen in the same month in 2022 (USD 62.7 billion);
- Despite the disappointing result, it does not change the scenario of solid Brazilian external accounts

Current Account Balance and FDI (YTD, USD Billion)

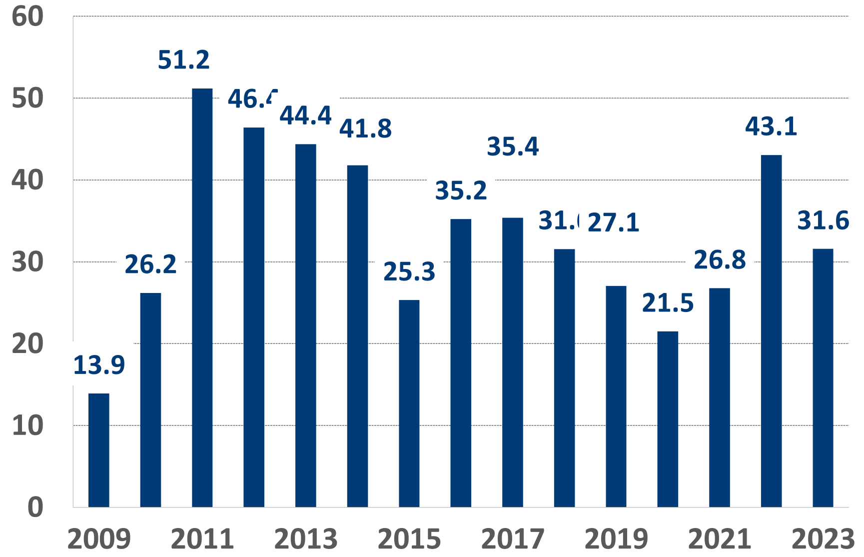


Foreign Direct Investment (USD Billion)



Foreign Direct Investment (Accumulated 12M, USD Billion and % GDP)

Foreign Direct Investment (YTD, USD Billion)

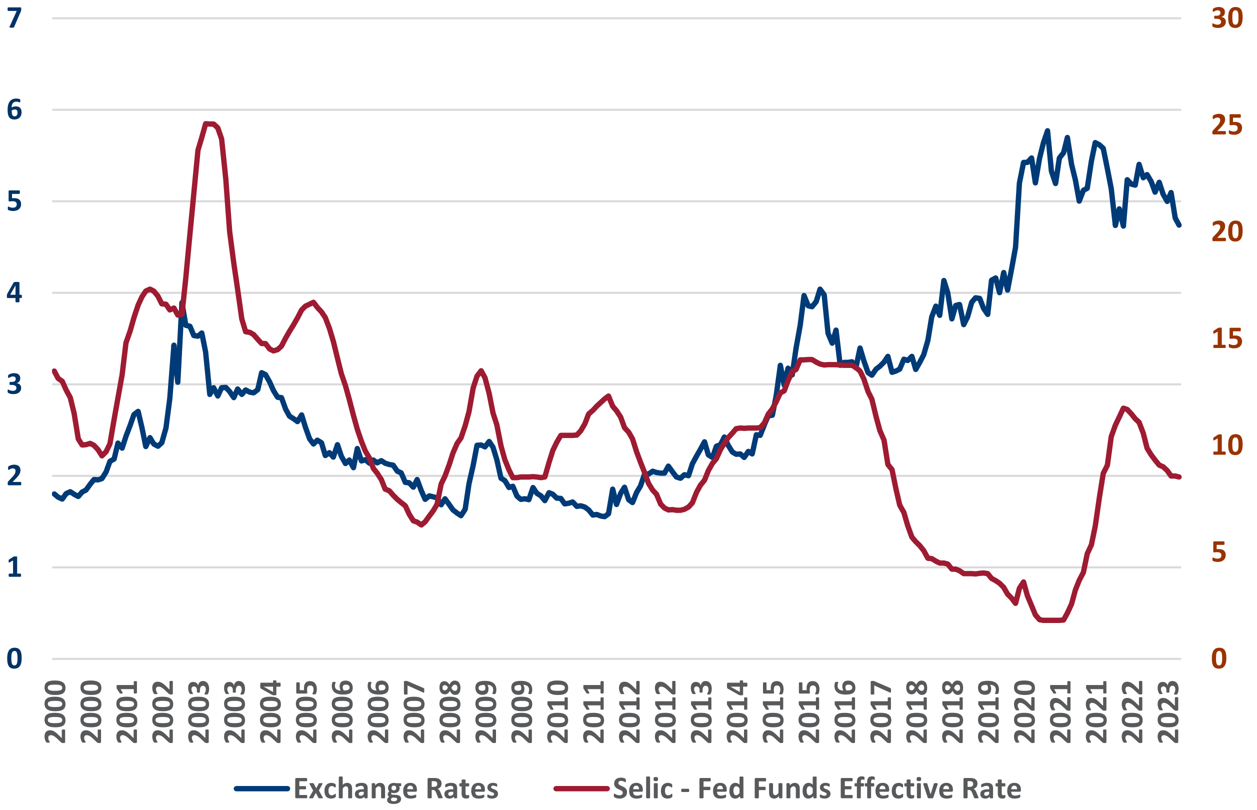


Source: BOCOM BBM, BCB

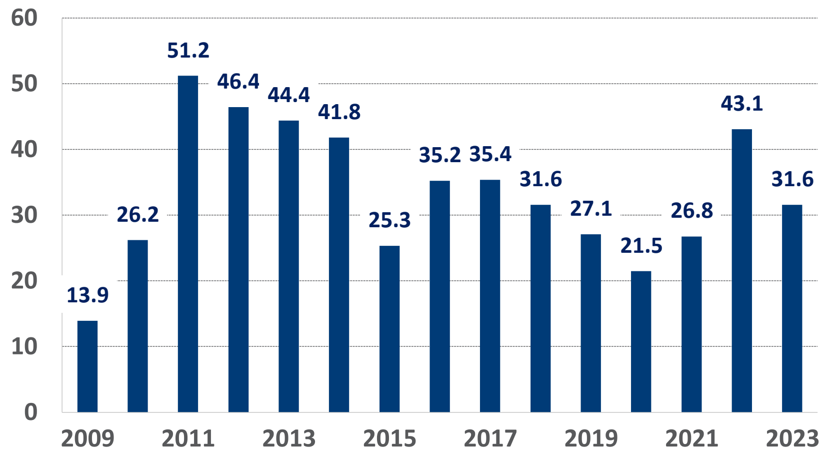
Brazil: External Sector

- The still high level of interest differential, terms of trade and foreign direct investment entering the economy has helped to strengthen the currency, which adds up to the reduction of economic uncertainty with the processing of the new fiscal anchor and the tax reform in the national congress.

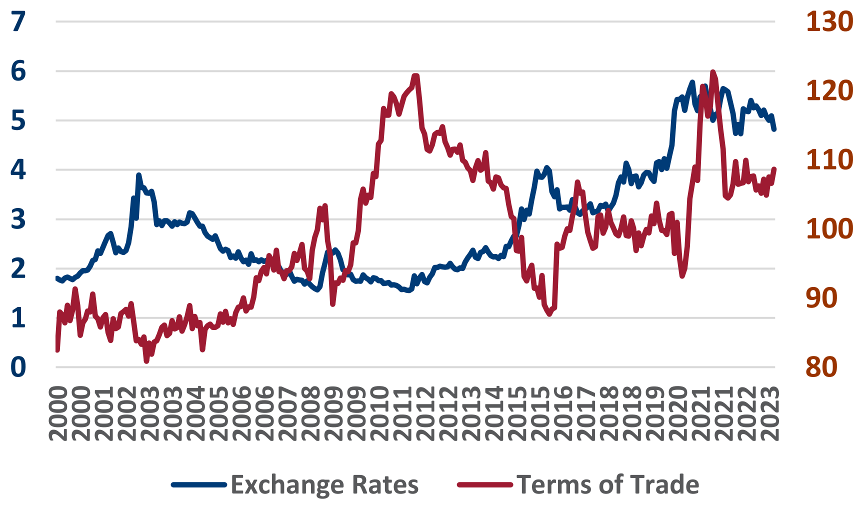
Interest Rate Differential x BRL



Foreign Direct Investment (YTD, USD Billion)



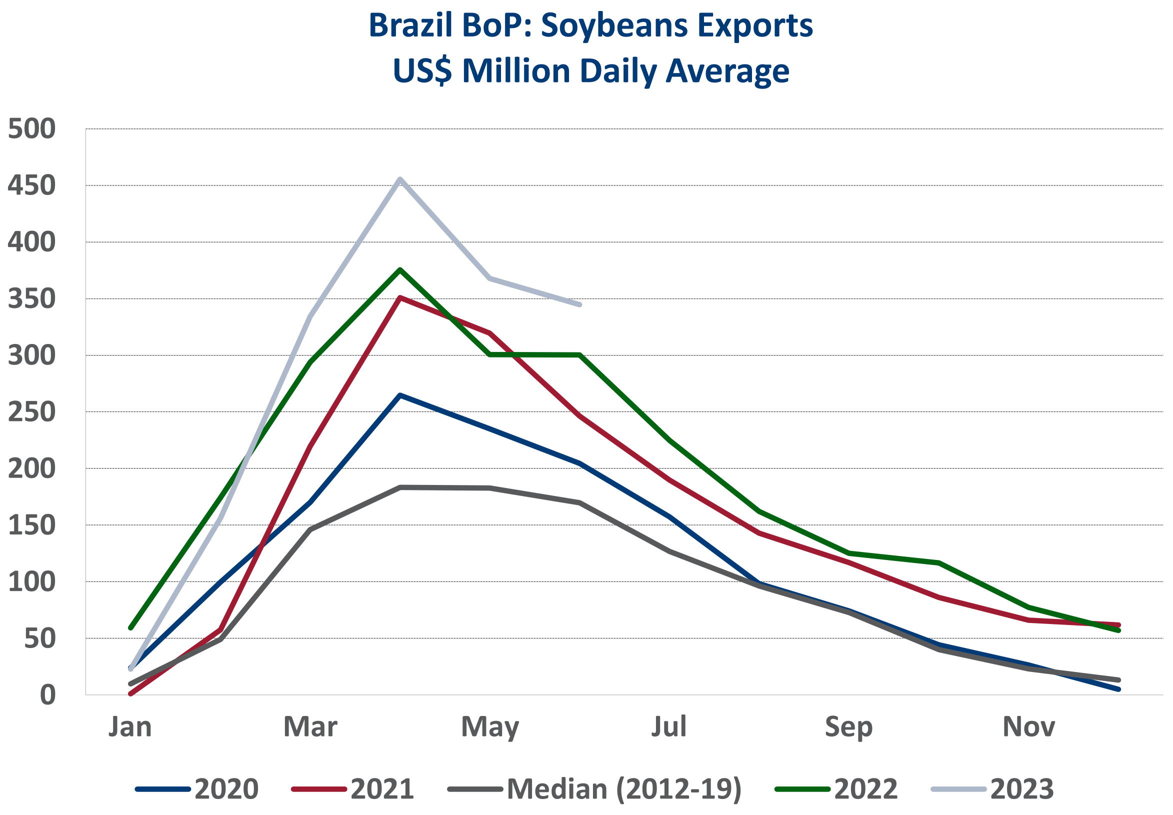
Terms of Trade x BRL

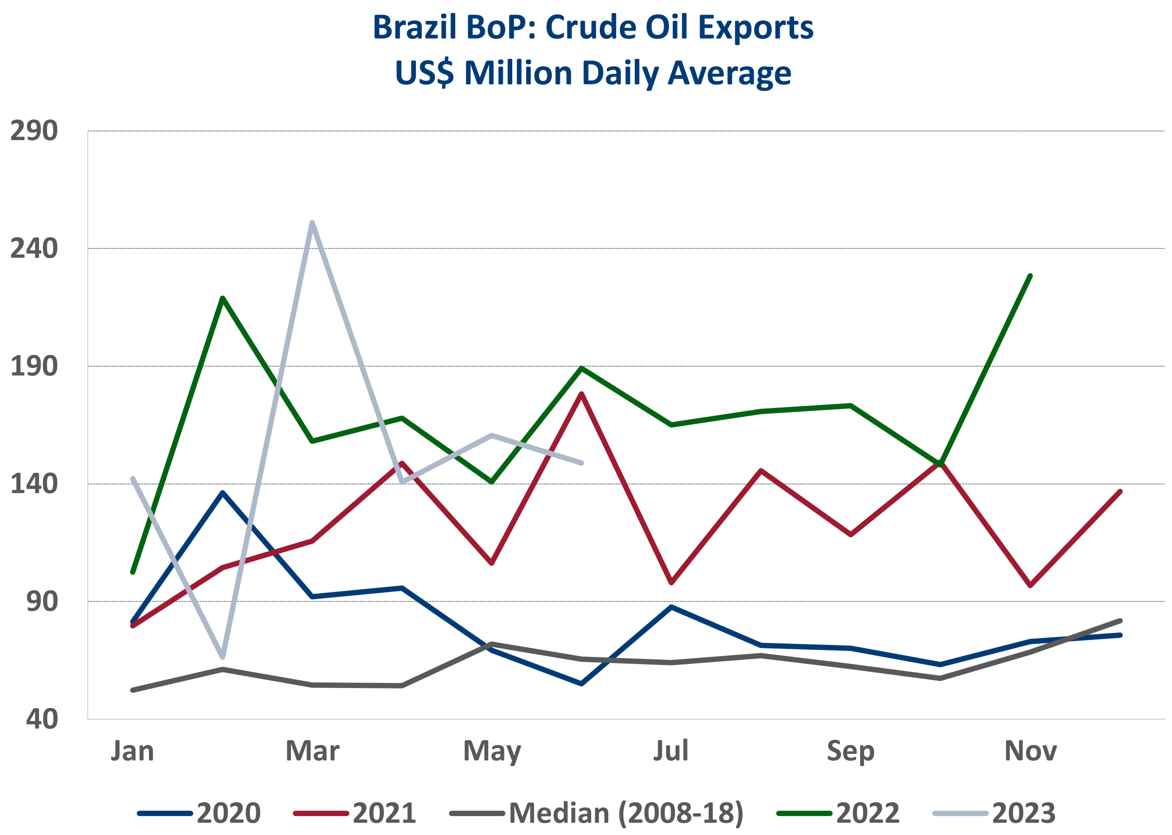


Source: BOCOM BBM, Bloomberg, Funcex, BCB

Brazil: External Sector

- Despite the drop in commodity prices on the external market, soybean exports in the first half of the year were 9.4% higher than the same period of last year, thanks to the record grain harvest that boosted the quantities exported in the year by 18.4% in the period.





Source: Secex, BOCOMBBM

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